



COMPTROLLER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



NOV 08 2005

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
COMMANDERS OF THE COMBATANT COMMANDS
INSPECTOR GENERAL OF THE DEPARTMENT OF
DEFENSE
DIRECTOR, ADMINISTRATION AND MANAGEMENT
DIRECTORS OF THE DEFENSE AGENCIES

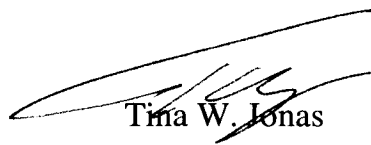
SUBJECT: Fiscal Year (FY) 2006 Guidance for the Preparation of the Statement of Assurance

Each Department of Defense (DoD) Component must submit to the Secretary of Defense **no later than September 1, 2006**, an annual Statement of Assurance (SOA) signed by the Component's Head (or principal deputy). This is a standing requirement of the Office of Management and Budget Circular A-123, "Management's Responsibility for Controls," which complies with the "Federal Managers' Financial Integrity Act (FMFIA) of 1982." We cannot extend this suspense.

Attached is the annual guidance for preparing your FY 2006 SOA, which is also available on our website: <http://www.dod.mil/comptroller/fmfia/index.html#latest>. The annual guidance is provided in three parts. Part I includes the directions for the statement of assurance on the effectiveness of internal controls for programs, administrative activities and operations. Part II includes the directions for the newly required assurance statement on the effectiveness of internal controls over financial reporting, and Part III explains the scorecard criteria for the statement of assurance in FY 2006.

All Components must comply with Parts I and III of the annual guidance, but not all of the Components have a requirement for the separate statement of assurance over financial reporting. Pages 11 and 12 in Part II of the annual guidance provide the list of Components required to submit the statement of assurance over financial reporting.

For more information, please contact Ms. Peggy Johnson, the DoD Manager's Internal Control (MIC) Program Coordinator, by e-mail at peggy.johnson@osd.mil or commercial (703) 602-0300, ext. 124, DSN 332-0300, ext. 124.


Tina W. Jonas

Attachment:
As stated

PART I

GUIDELINES

FOR PREPARATION OF THE

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)

OVERALL

ANNUAL STATEMENT OF ASSURANCE

FISCAL YEAR 2006

PART I

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Department of Defense Requirements for the Consolidated Annual Statement of Assurance (FMFIA Overall and FMFIA Over Financial Reporting)

The Federal Managers' Financial Integrity Act (FMFIA) Overall Process Statement of Assurance will disclose material weaknesses identified by an assessment of the effectiveness of the Component's internal controls for the overall program, administrative, and operational activities and describe the plans and schedules to correct those weaknesses. See guidelines beginning on page 5 of this annual guidance.

Only the Department of Defense (DoD) Components with Financial Statement Reporting Entities (FSREs) that are listed on pages 11-12 in Part II of this annual guidance, will also provide the FMFIA Over Financial Reporting Statement(s) of Assurance on the effectiveness of internal control over financial reporting as a subset to the FMFIA Overall Statement of Assurance for each FSRE. See detailed instructions in Part II of this annual guidance. **The Head (or principal deputy) of the Component must sign the statement.** This signature authority may not be delegated below the DoD Component principal deputy.

Submission Date: DoD Components must submit the Statement(s) of Assurance for both the FMFIA Overall Process and the FMFIA Over Financial Reporting Process, as required, no later than September 1, 2006. ABSOLUTELY NO EXTENSIONS TO THE SUSPENSE DATE WILL BE GIVEN.

The DoD Component Heads must submit Statements of Assurance following the format and content requirements of this annual guidance. Each Component will provide both electronic and hard copies of its fiscal year (FY) 2006 Statement(s) of Assurance. The electronic version should be emailed to peggy.johnson@osd.mil. **The electronic version of each Component's Statement of Assurance is required by September 1, 2006.** A paper copy should also be mailed to:

Office of the Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Room 3E620, Pentagon
Washington, DC 20301-1100
Attention: Managers' Internal Control Program Coordinator

Each Component shall submit **its original (paper) signed copy** of the Statement of Assurance directly to the Secretary of Defense **no later than September 1, 2006.** **ABSOLUTELY NO EXTENSIONS TO THE SUSPENSE DATE WILL BE GIVEN.**

The statement must have the signature of either the Head (or principal deputy) of the DoD Component. The mailing address is:

Honorable Donald H. Rumsfeld
Secretary of Defense
1000 Defense Pentagon
Washington, DC 20301-1000

In addition, information copies of the Statement of Assurance from the Combatant Commands shall be furnished to the Chairman of the Joint Chiefs of Staff. The mailing address is:

General Peter Pace, USMC
Chairman of the Joint Chiefs of Staff
9999 Joint Staff Pentagon
Washington, DC 20318-9999

Since FY 2003, the Department has used a scorecard to grade the performance of the DoD Components' Statements of Assurance. The scorecard grades five categories: 1) report timeliness; 2) format, to include accuracy and completeness of the report; 3) extent of Component-wide program execution; 4) extent of Component-wide training conducted, and 5) weakness reporting (full disclosure and prompt resolution of previously reported weaknesses). The scorecard criteria for FY 2006 is contained in Part III of this annual guidance.

Timely reporting is essential. Any Statement of Assurance that is received over 2 calendar days late will receive a lower (amber) score in the reporting timeliness category; over 5 calendar days late receives a penalty (red) score; any statement received over 15 days past the suspense date will receive a large negative (black) score for a significant reduction of the overall score. Statements significantly late jeopardize the entire Department's ability to meet the Office of Management and Budget deadlines.

Component Heads are encouraged to submit their Statement of Assurance on or in advance of the suspense date of September 1, 2006. Receipt of the Statements of Assurance at least 7 calendar days in advance will receive an extra credit score in the timeliness category.

FMFIA Overall Statement of Assurance Guidelines

The FMFIA Overall Process Statement of Assurance will disclose material weaknesses identified by an assessment of the effectiveness and efficiency of operations and compliance with applicable laws and regulations for the overall program, administrative, and operational activities. This statement will describe the plans and schedules to correct any material weaknesses reported.

The statement is effective *as of the date the statement is signed*. Material weaknesses should not be reported as closed until all corrective actions have been implemented and a validation of closure accomplished. If a material weakness is expected to be corrected within the 4th Quarter (Qtr) of FY 2006 but all actions are not completed when the statement is signed, the DoD Component Head should report the material weakness as still ongoing.

The list of DoD Components required to submit the FMFIA Overall Process Statement of Assurance is on page 7. Each FMFIA Overall Process Statement of Assurance submission shall consist of the following:

1. A cover memorandum, **addressed to the Secretary of Defense and signed by the Head of the DoD Component, or the principal deputy**, providing the assessment by the Component's senior management as to whether there is reasonable assurance that the Component's internal controls are in place, operating effectively, and being used for the overall programs, administrative and operational activities to include the effectiveness and efficiency of operations and compliance with applicable laws and regulations. If the DoD Component is identified as having a FSRE (see Table 1, pages 11 and 12, in Part II of this annual guidance), the DoD Component must also follow the guidelines provided in Part II of this annual guidance. Under the Office of Management and Budget (OMB) Circular A-123, "Management's Responsibility for Internal Control," August 5, 2005, the FMFIA Overall Process Statement of Assurance must take one of the following three forms (see sample cover memorandum on page 8 of Part I):

a. An unqualified Statement of Assurance (reasonable assurance with no material weaknesses reported). Each unqualified statement shall provide a firm basis for that position, which the Head (or principal deputy) will summarize in the cover memorandum. TAB A will contain a more extensive explanation of how the assessment helped justify the Head (or principal deputy) of the Component's assertion of an unqualified statement.

b. A qualified Statement of Assurance (reasonable assurance with exception of one or more material weakness(es) noted). The cover memorandum must cite the material weaknesses in internal controls that preclude an unqualified statement. TAB B will fully describe all weaknesses, the corrective actions being taken and by whom, and the projected dates of correction for each action.

c. A Statement of No Assurance (no reasonable assurance because no assessments conducted or the noted material weaknesses are pervasive). The Head (or principal deputy) shall provide an extensive rationale for this position.

2. TAB A: A description of how the DoD Component conducted its assurance evaluation for the FMFIA Overall Process only and, based on that evaluation, a statement describing how the Head (or principal deputy) achieved this level of reasonable assurance (detailed discussion on pages 11-15). In addition, TAB A should include a brief summary of the most significant actions taken by the DoD Component during FY 2006 to strengthen specific internal controls, the MIC execution, the internal control training, and other improvements. Examples of other improvements are the protection of government assets, efficiency of operations, conservation of resources, and improvements to customer needs.

3. TAB B-1: A list of the titles of all uncorrected and corrected material weaknesses. See pages 17 and 18 for additional guidance.

4. TAB B-2: Detailed narrative descriptions of all uncorrected material weaknesses including the plans and schedules for the corrective action(s). Include those identified during the current year and those disclosed in prior years with updated information. Narratives for updating material weaknesses identified in prior years will explain the rationale for any changes to previously reported corrective milestone dates. See pages 19 through 22.

5. TAB B-3: A brief narrative describing the material weaknesses corrected in the current year, including the most significant actions taken to correct the weakness. This section will include all material weaknesses corrected in FY 2006 that were identified in either current or prior year(s). For each corrected material weakness, the last milestone will describe the method used to validate the corrective action to include a certification that the corrective action has effectively resolved the weakness. See pages 22 through 24.

6. TAB C: **Used only by the Office of the Secretary of Defense Component** to report systemic weaknesses. OSD Principal Staff must identify and/or report the status of “systemic weaknesses” that fall within their area of functional responsibility. Systemic weaknesses can be identified from two sources. First, systemic weaknesses result when internal control problems are reported to the Secretary of Defense by more than one DoD Component and the weakness is determined to potentially jeopardize the Department’s operations. Secondly, OSD Principal Staff can identify new systemic internal control weaknesses for inclusion in the DoD FMFIA Overall Process Statement of Assurance. The OSD Director of Administration and Management will consolidate all OSD Principal Staff and DoD Field Activities Statements of Assurance and submit to the Secretary of Defense. The OSD Principal Staff will include in their FY 2006 Statement of Assurance report to the OSD Director of Administration and Management any new systemic weaknesses or the status of all existing systemic weaknesses, for which the OSD Principal Staff is the functional proponent, as defined on pages 14 and 15. For systemic status reports, use the same format as described in TAB B on pages 16 through 26. It is imperative that reports for systemic weaknesses be clearly identified as systemic weaknesses entitled, **SYSTEMIC WEAKNESS REPORTING**.

TABLE 1
(DoD Components Required to Submit FY 2006
Annual Statement of Assurance for the FMFIA Overall Process)

Office of the Secretary of Defense
Department of the Army
Department of the Navy
Department of the Air Force
Joint Staff
United States European Command
North American Aerospace Defense / United States Northern Command
United States Transportation Command
United States Pacific Command
United States Southern Command
United States Joint Forces Command
United States Central Command
United States Special Operations Command
United States Strategic Command
Inspector General, Department of Defense
Defense Advanced Research Projects Agency
Defense Business Transformation Agency
Defense Commissary Agency
Defense Contract Audit Agency
Defense Contract Management Agency
Defense Finance and Accounting Service
Defense Information Systems Agency
Defense Intelligence Agency
Defense Logistics Agency
Defense Security Cooperation Agency
Defense Security Service
Defense Threat Reduction Agency
Missile Defense Agency
National Defense University
National Geospatial-Intelligence Agency
National Reconnaissance Office
National Security Agency / Central Security Service
Pentagon Force Protection Agency
Uniformed Services University of the Health Sciences

FMFIA OVERALL STATEMENT OF ASSURANCE WHEN NO STATEMENT OF ASSURANCE OVER FINANCIAL REPORTING IS REQUIRED

Sample Cover Memorandum

MEMORANDUM FOR THE SECRETARY OF DEFENSE (Components must address the cover memorandum to the Secretary of Defense. If addressed to other than the Secretary of Defense, the memorandum will be returned for revision. Revisions risk delays that could adversely affect the accuracy and timeliness of the Secretary of Defense Statement of Assurance to the OMB, Congress, and the President.)

SUBJECT: Annual Statement Required under the Federal Managers' Financial Integrity Act (FMFIA) of 1982

As **(title of Component Head or Principal Deputy)** of **(name of Component)**, I recognize that the **(name of Component's)** management is responsible for establishing and maintaining effective internal controls to meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). I am able to provide **[the statement must take one of three forms: "an unqualified statement of reasonable assurance" (no material weaknesses being reported); "a qualified statement of reasonable assurance" (one or more material weaknesses being reported); or "no assurance" (no processes in place to assess the internal controls or pervasive material weaknesses that cannot be assessed)]** that the **(name of Component)** internal controls meet the objectives of FMFIA overall programs, administrative, and operations **(if qualified)** with the exception of **(number)** material weakness(es) described in TAB B. These material weaknesses were found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of the date of this memorandum. Other than the material weaknesses noted in TAB B, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.

Component's statement will include the following paragraph if the Component identified material weaknesses, either in the current fiscal year or past fiscal years:

The **[Component]** FMFIA overall evaluation did identify material weaknesses. TAB B-1 is a list of material weaknesses that still require corrective action and those corrected during the period. TAB B-2 is an individual narrative for each uncorrected material weakness listed in TAB B-1. **(Include the previous two sentences if your Component has uncorrected material weaknesses.)** TAB B-3 is an individual narrative for each material weakness corrected during the period. **(Include the previous sentence if your Component corrected any material weaknesses during the past fiscal year.)**

[(The statement must include the following if the form of the statement is unqualified or qualified) TAB A provides additional information on how the (name of Component) conducted the assessment of internal controls for the FMFIA overall process, which was conducted according to OMB Circular A-123, Management's Responsibility for Internal Control. In addition, TAB A provides a summary of the significant accomplishments and actions taken to improve Component internal controls during the past year.]

(Signature of Component Head or Principal Deputy)

[An example of a cover memorandum demonstrating a FMFIA Overall Process Statement of Assurance that also includes one or more FMFIA Over Financial Reporting Process Statement(s) of Assurance begins on page 5 of Part II.]

Conceptualizing a Material Weakness in the FMFIA Overall Process

Each manager is responsible for establishing internal controls in his or her area of responsibility and continuously assessing the effectiveness of the internal controls to meet intended mission objectives. DoD Components are expected to conduct, at a minimum, annual independent assessments that may identify internal control weaknesses; however, management should avoid duplication of ongoing reviews or inspections of internal controls. Continuous monitoring, supplemented by periodic assessments, should be documented in enough detail to support management's assertion as to the effectiveness of internal controls.

Managers should identify deficiencies in internal controls. One or more deficiencies in the design or operation of an internal control that management believes are significant and could adversely affect the organization's ability to meet its mission objectives is a reportable condition. The organization will track reportable conditions internally. A reportable condition that the DoD Component Head determines to be significant enough to be reported outside the Component will be considered a material weakness and included in the FMFIA Overall Process Statement of Assurance. The designation of a material weakness is a management judgment that should be based on relative risk. Although the appearance of a weakness in an audit report does not necessarily warrant reporting it as a material weakness in the Component's FMFIA Overall Process Statement of Assurance, OMB Circular A-123 states that serious consideration should be given to the views of the Inspector General. The bottom line is that the weakness is considered material if the Head (or principal deputy) of the Component determines to include the weakness in the FMFIA Overall Process Statement of Assurance submitted to the Secretary of Defense. Therefore, the decision of whether a weakness is "material" is leadership's judgment except for "significant deficiencies" that were identified under the Federal Information Security Management Act (FISMA); these must be reported as material weaknesses in the FMFIA Overall Process Statement of Assurance.

OMB Circular A-123, Management's Responsibility for Internal Control, page 14, Section IV, B., "Identification of Deficiencies," states that managers are encouraged to report material weaknesses as this reflects positively on the agency's commitment to recognize and address management problems. Neglecting to report material weaknesses reflects adversely on the agency and could place the agency at risk.

A systemic weakness is a material weakness that is reported by more than one Component. Once reported, the same material or systemic weakness should never reappear as a new, re-titled weakness in future FMFIA Overall Process Statements of Assurance even when a subsequent audit report has revealed new instances of the same problem. Instead, the original weakness should reflect that it was completed. The new instance should retain the same name as the original weakness but show a new date identified. For example, consider a material or systemic weakness that a Component originally identified in FY 2000 and corrected in FY 2003. Then in FY 2006, audit reports identify related problems and the component wants to report it as a new material weakness in FY 2006. The material weakness should retain the same title as the original, but the "Year Identified" date would now appear as FY 2006, not FY 2000.

Weaknesses that slip year after year and do not meet the targeted correction dates reflect negatively on the Department's commitment to improve. Therefore, Components should resolve material weaknesses as quickly as possible and ensure that the targeted correction dates are met.

Components must be careful in defining and setting the scope of the material weakness problem. For example, if the deficiency is due to inadequate controls for effectively implementing the equal employment opportunity (EEO) requirements, the reported weakness and milestones should address that problem. It is incorrect to define the problem in a broad category such as the civilian hiring practices, and then include corrective actions that narrowly address the deficiency in the EEO requirements. In this case, the definition and specification of the weakness scope is too broad (i.e., implying an action greater than the Component intends to correct).

Sometimes, it is preferable to address several related problems in one weakness statement; however, Components should be cautious when defining a weakness. For example, in addition to the hypothetical weakness stated above, a Component might have concluded that there are other control problems related to civilian hiring practices. Combining several problems and reporting one weakness under a broad statement that the Component will correct deficiencies in civilian hiring practices may overstate the dimensions of the weakness. Confine the weakness statement to the scope of the specific problem(s) addressed. Consolidation of like weaknesses into a single comprehensive weakness is encouraged only when appropriate conditions apply. Avoid bundling a number of related weaknesses for the principal purpose of reducing the number of material weaknesses reported. Weaknesses defined too broadly are very difficult to resolve and usually result in repeatedly missed targeted correction dates.

For FY 2006, the Department will not require Components to identify or report Section 4 nonconformance weaknesses. Instead, the Department will develop a Defense-wide reporting based on the progress made by the Business Management Modernization Program.

DESCRIPTION OF THE CONCEPT OF REASONABLE ASSURANCE AND HOW THE EVALUATION WAS CONDUCTED

(TAB A)

This section describes the concept of reasonable assurance and the evaluation process used. In TAB A, use the following template to help describe the concept of reasonable assurance:

The **(name of Component)** senior management evaluated the system of internal accounting and administrative controls, in effect during the fiscal year as of the date of this memorandum, according to the guidance in Office of Management and Budget (OMB) Circular No. A-123, “Management’s Responsibility for Internal Control,” August 5, 2005. The OMB guidelines were issued in conjunction with the Comptroller General of the United States, as required by the “Federal Managers’ Financial Integrity Act of 1982.” Included is an evaluation of whether the system of internal accounting and administrative control for the **(name of Component)** is in compliance with standards prescribed by the Comptroller General. **NOTE: If a self-evaluation of the system of internal accounting and administrative control was not conducted, or the evaluation was insufficient when compared to the Guidelines, indicate that fact and provide an explanation.**

The objectives of the system of internal accounting and administrative control of the **(name of Component)** are to provide reasonable assurance that:

The obligations and costs are in compliance with applicable law;

Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

Revenues and expenditures applicable to agency operations are properly recorded and accounted for, to permit the preparation of reliable accounting, financial and statistical reports and to maintain accountability over the assets.

The evaluation of internal controls extends to every responsibility and activity undertaken by **(name of Component)** and applies to program, administrative and operational controls. Furthermore, the concept of reasonable assurance recognizes that (1) the cost of internal controls should not exceed the benefits expected to be derived and (2) the benefits include reducing the risk associated with failing to achieve the stated objectives. Moreover, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, congressional restrictions, and other factors. Finally, projection of any system evaluation to future periods is subject to risk that procedures may be inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate. Therefore, this statement of reasonable assurance is provided within the limits of the preceding description.

The **(name of Component)** evaluated the system of internal control in accordance with the guidelines identified above. The results indicate that the system of internal accounting and administrative control of the **(name of Component)** in effect during the fiscal year **(year, i.e., 2006)** as of the date of this memorandum, taken as a whole, **(complies/does not comply)** with

the requirement to provide reasonable assurance that the above mentioned objectives were achieved. This position on reasonable assurance is within the limits described in the preceding paragraph.

The **(Name of Component)** evaluated its system of internal accounting and administrative control using the following process for conducting the evaluation. **[The below is a list of items the Component should consider including to explain how the Component conducted the evaluation.]**

1. The progress achieved in institutionalizing internal controls (i.e., a brief description of how the Component Managers' Internal Control (MIC) Program is applied or reviewed for compliance also could be used here if it has already been fully implemented);
2. Any improvements to MIC Program coverage (address the expected benefits and related costs of control procedures using estimates and managerial judgment);
3. A description of the problems encountered in implementing the MIC Program;
4. Other considerations (e.g., resource constraints, technological bottlenecks, and operational or mission considerations) affecting the MIC Program;
5. Any deviations from the process as outlined in the OMB Circular A-123;
6. Any special concerns addressed in reports by the Inspector General (IG), DoD or Component audit, investigation, inspection and/or internal review organizations regarding MIC Program progress, needs, and/or problems;
7. Methods, mechanisms, or techniques employed in the discovery or execution phases of the program. The following are examples of methods, mechanisms, or techniques:
 - a. MIC Program weakness tracking system (number of weaknesses and milestones);
 - b. Component Inspector General or Audit Service findings;
 - c. Reports of Component internal reviews and inspections;
 - d. IG, DoD reports and reviews;
 - e. Most significant MIC Program accomplishments achieved during FY 2006;
 - f. MIC Program training;
 - g. MIC Program performance standards (e.g., such as those found in the GAO Internal Control Management and Evaluation Tool (August 2001));

- h. Government Accountability Office (GAO) reports and reviews;
- i. Review of Office of the Secretary of Defense (OSD) Functional Proponent Proposals (e.g., systemic weaknesses);
- j. Information Technology initiatives;
- k. MIC Program references in directives, regulations, and other guidance;
- l. Congressional reviews and hearings;
- m. Command or other subordinate organization "Letters of Assurance;"
- n. Productivity statistics;
- o. Defense Regional Interservice Support studies;
- p. Management reviews in other functional areas (e.g., procurement, communications and intelligence. financial, or environmental);
- q. Quality Assurance reviews;
- r. "Hot Line" reports.
- s. Evidence that assessments have been conducted by including examples of deficiencies found that do not warrant reporting as material weaknesses and the actions taken or planned to resolve these deficiencies. Use the following format:

Description of Issue : Reconciliation of the Government Purchase Card Accounts.

Accomplishments :

- By standardizing processes, limiting the number of purchase cardholders, and using automated tools, the elapsed time from billing period closing to forwarding the account reconciliation to the Defense Finance and Accounting Service (DFAS) has been reduced from 12 days to 4 days.
- The reduction of process time enables DFAS to pay the U.S. Bank within established parameters, thus preventing payment of interest and allowing the Defense Commissary Agency to earn rebates.
- Improvements in oversight capabilities has drastically reduced the agency's delinquency rates and increased rebate dollars.
- FY 2005 1st Quarter rebates totaled \$124,000 compared to FY 2004 1st Quarter of \$65,000.

Instructions for the DoD Components' Systemic Weakness

As a last disclosure in TAB A, all DoD Components shall develop a section entitled "Systemic Weaknesses." Components will list below the title of each OSD systemic weakness reported in the FY 2005 DoD Statement of Assurance, all the material weaknesses, both corrected and uncorrected, contained in the organization's current fiscal year annual FMFIA Overall Process Statement of Assurance that are related to the FY 2005 systemic weaknesses. Systemic weaknesses reported in the FY 2005 DoD Statement of Assurance were:

1. Department of Defense Financial Management Systems and Processes – DoD financial and business management systems and processes are costly to maintain and operate, not fully integrated, and do not provide information that is reliable, timely, and accurate. The estimated correction date is 4th Quarter, FY 2015. (Office of the Under Secretary of Defense (Acquisition, Technology, Logistics) and the Office of the Under Secretary of Defense (Comptroller))
2. Management of Information Technology and Assurance – DoD information systems are potentially vulnerable to an information warfare attack. In addition, this issue has also been reported as a "significant deficiency" under the reporting requirements of the Federal Information Security Management Act. The estimated correction date is 3rd Quarter, FY 2007. (Office of the Assistant Secretary of Defense (Network Information and Integration))
3. Environmental Liabilities – The Department of Defense has not developed the policies, procedures, and methodologies needed to ensure that cleanup costs for all of its ongoing and inactive and/or closed operations are identified, consistently estimated, and appropriately reported. Site inventories and cost methodologies to identify budget requirements and financial liabilities continue to need improvement. The estimated correction date is 1st Quarter, FY 2006. The Financial Improvement Audit and Readiness Plan under development may impact the correction target date projection. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))
4. Personnel Security Investigations Program – The Department of Defense hiring is adversely affected because personnel security investigations are backlogged. The estimated correction date is 4th Quarter, FY 2006. (Office of the Under Secretary of Defense (Intelligence))
5. Real Property Infrastructure – The Department of Defense has not adequately managed the real property infrastructure to halt the deterioration or obsolescence of facilities on military installations. The estimated correction date is 1st Quarter, FY 2008. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))

6. Government Card Program Management – Instances of misuse, abuse, and fraud in respect to purchase and travel card use, and centrally billed accounts have been attributed to inadequate DoD emphasis on proper use of the cards, poorly enforced controls, and lax oversight. The estimated correction date is 4th Quarter, FY 2006. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) for Purchase Cards, and Office of the Under Secretary of Defense (Comptroller) for Travel Cards)

7. Valuation of Plant, Property and Equipment on Financial Reports – The Department of Defense is unable to accurately report the value of property, plant, and equipment on its financial statements. The estimated correction date is 4th Quarter, FY 2006 for Increment 1 – Full Operational Capability. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))

8. Valuation of Inventory on Financial Reports – The valuation of inventory is not always correctly reported. The estimated correction date is 3rd Quarter, FY 2006. The Financial Improvement and Audit Readiness Plan under development may impact the correction target date projection. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))

9. Improper Use of Non-Department of Defense Contracting Vehicles – Non-Department of Defense contracting vehicles have been used improperly to procure services or supplies. The estimated correction date is 2nd Quarter, FY 2006. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))

10. Department of Defense Contracting for Services – The Office of the Inspector General, Department of Defense and the Government Accountability Office have identified deficiencies in the policy for and the execution of procurement for services. The estimated correction date is 2nd Quarter, FY 2007. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))

11. Inaccuracy of Contracting Federal Procurement Data Reporting – The new Federal Procurement Data System is not fully functional causing inaccurate procurement reporting data and increased costs required for continued maintenance of legacy systems. The estimated correction date is 2nd Quarter, FY 2006. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))

MATERIAL WEAKNESS / CORRECTIVE ACTIONS

(TAB B)

(Also for TABs D, E, F and so on, for FMFIA Over Financial Reporting)

This section presents internal control weakness information in three subset tabs:

1. A listing of the titles of all uncorrected and corrected material weaknesses as of the conclusion of the current period along with actual and projected correction dates. (TAB B-1)
2. Narratives for the uncorrected material weaknesses identified in the summary listing. (TAB B-2)
3. Narratives for all material weaknesses corrected during the current period. (TAB B-3)

The three subset tabs are illustrated on the following pages.

LISTS OF ALL UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES

(TAB B-1)

(Also for TABs D-1, E-1, F-1 and so on, for FMFIA Over Financial Reporting)

Components should prepare this section after completing both TABs B-2 and TAB B-3 since it is a summary listing of TAB B-2 and TAB B-3 weakness titles and correction dates. Divide the material weakness titles into three groupings: Uncorrected Weaknesses Identified During the Period (the current fiscal year); Uncorrected Weaknesses Identified During Prior Periods; and Corrected Weaknesses Identified During All Periods.

Uncorrected Weaknesses Identified During the Period: (List by DoD functional category, in the order provided on page 24-26.)

<u>Title</u>	<u>Quarter (QTR) and Fiscal Year (FY)</u> <u>Targeted Correction Date</u>	<u>Page #</u>
(1)	(4)	(5)

Uncorrected Weaknesses Identified During Prior Periods: (List by DoD functional category, in the order provided on page 24-26.)

<u>Title</u>	<u>Year First Reported</u>	<u>Correction QTR & FY Date</u>		<u>Page #</u>
		<u>Per Last Annual Statement</u>	<u>Per This Annual Statement</u>	
(1)	(2)	(3)	(4)	(5)

Corrected Weaknesses Identified During All Periods: (List by DoD functional category, in the order provided on page 24-26.)

<u>Title</u>	<u>Year First Reported</u>	<u>Page #</u>
(1)	(2)	(5)

NOTES:

- (1) Titles should be identical to those found on the material weakness narratives provided in TAB B-2 or B-3.
- (2) Use the fiscal year in which this weakness was first reported.
- (3) This is the **quarter and fiscal year** noted as the targeted date for correction of the material weakness in the Component's FY 2005 Annual Statement.
- (4) This is the **quarter and fiscal year** noted as the targeted date for correction of the material weakness in the Component's FY 2006 Annual Statement.
- (5) The page number is that of the first page of the material weakness narrative as found in TAB B-2 or B-3.

TAB B-1 EXAMPLE

(TAB B-1)

LISTS OF ALL UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES

Uncorrected Weaknesses Identified During the Period:

<u>Title</u>	<u>Quarter (QTR) and Fiscal Year (FY)</u> <u>Targeted Correction Date</u>	<u>Page #</u>
<u>Category: Communications and/or Intelligence and/or Security</u>		
Lack of Security Policy	2nd Qtr, FY 2008	TAB B-2-1

Uncorrected Weaknesses Identified During Prior Periods:

<u>Title</u>	<u>Year First Reported</u>	<u>Correction Qtr & FY Date</u> <u>Per Last Annual Statement</u>	<u>Per This Annual Statement</u>	<u>Page #</u>
<u>Category: Contract Administration</u>				
Contract Administration of Service Contracts	FY 2003	2 nd Qtr, FY 2006	4 th Qtr, FY 2007	TAB B-2-6
<u>Category: Information Technology</u>				
Combating Computer Software Piracy	FY 2003	1 st Qtr, FY 2007	1 st Qtr, FY 2007	TAB B-2-8

Corrected Weaknesses Identified During All Periods:

<u>Title</u>	<u>Year First Reported</u>	<u>Page #</u>
<u>Category: Supply Operations</u>		
Independent Logistics Assessment (ILA) Process.	FY 2004	TAB B-3-1
<u>Category: Force Readiness</u>		
Inadequate Procedures for Projecting Training Requirements	FY 2005	TAB B-3-5

UNCORRECTED MATERIAL WEAKNESSES STATUS OF CORRECTIVE ACTIONS

(TAB B-2)

(Also for TABs D-2, E-2, F-2 and so on, for FMFIA Over Financial Reporting)

This attachment should provide a narrative for each uncorrected material weakness identified by the Component for which corrective actions have NOT been completed, regardless of the year of first reporting. Begin each weakness at the top of a new page. Group the narratives contained in TAB B-2 into two subsections: “Uncorrected Weaknesses Identified During the Period” and “Uncorrected Weaknesses Identified During Prior Periods.”

The numbers and letters used below are provided only to assist in your comprehension of this guidance and should not appear in your statement of assurance for either the FMFIA Overall Process or the FMFIA Over Financial Reporting Process. Only the headings should appear.

Spell out acronyms the first time they are used in each individual material weakness narrative. Deviation from this guidance may require your Component to revise and resubmit the DoD Component statement. A delay due to a required revision has the potential to adversely affect the accuracy of the DoD statement.

Simplify your material weakness status reports to the greatest extent possible by summarizing what previously was presented in detail. **Each uncorrected material weakness report should be three pages or less. Avoid use of the passive voice, minimize the use of acronyms, and use “bullets” to describe both the actions taken and planned. Narratives should be succinct, void of technical jargon, and easy for the general public to interpret.**

The narratives shall follow the format below. **USE THE HEADINGS INDICATED BELOW IN BOLD TYPE IN THE EXACT SEQUENCE.** Do not exclude sections, if they are not applicable, simply note “N/A” following the heading. Do not include the numbers that appear before the headings below; they are included only to assist in your comprehension of this guidance. An example of TAB B-2 is shown on pages 21-22.

1. **Title and Description of Issue:** Provide title and confine the weakness description to three sentences if possible.
2. **Functional Category:** Indicate one of the 16 functional categories provided on pages 24-26 of this guidance, e.g., “Force Readiness.” For the FMFIA Over Financial Reporting, identify the focus area, e.g., “Financial Reporting, Fund Balance with Treasury.”
3. **Component:** Indicate which Component is reporting the weakness for the FMFIA Overall. For the FMFIA Over Financial Reporting, indicate the Component and the name of the Financial Statement Reporting Entity.
4. **Senior Official In Charge:** Identify the name and title of the senior official in charge of ensuring this weakness is resolved according to targeted milestone projections.

5. Pace of Corrective Action: (For all targeted correction dates, Components must show both the Quarter and Fiscal Year, e.g., 1st Qtr, FY 2006, 2nd Qtr, FY 2007, etc.)

Year Identified: Fiscal year of the annual statement of assurance in which Component first reported the weakness.

Original Targeted Correction Date: Quarter and fiscal year of the targeted correction date as Component first reported it.

Targeted Correction Date in Last Year's Report: Quarter and fiscal year of the targeted correction date as it was reported in the Component's FY 2005 annual FMFIA Statement of Assurance.

Current Target Date: Quarter and fiscal year of targeted correction date per this report.

6. Reason For Change in Date: Reason for change in quarter and fiscal year of Current Target Date from the Target Correction Date in Last Report as indicated in item #5 above. If applicable, the reason for change should include a brief description of the impact (cost, operation) of any delay in correcting the weakness.

7. Validation Indicator: Briefly indicate the methodology that Components will use to certify the effectiveness of the corrective action(s) and the projected date that the certification will take place. In addition, indicate the role that the Inspector General, DoD or Component Audit Service will play in verification of the corrective action.

8. Results Indicator: Describe key results that have been or will be achieved in terms of performance measures. Performance measures are quantitative and/or qualitative measures that determine the benefits derived or will be derived from the corrective action and the overall impact of the correction on operations. If monetary benefits are determinable, state that information here. **NOTE: Specifically identify one or two defined performance measures or defined results that will be used to determine successful completion of the proposed remedial effort.**

9. Source(s) Identifying Weakness: Use the following other applicable sources: (a) MIC Program Evaluation; (b) IG, DoD; (c) Component Audit Service; (d) GAO; (e) Component internal review organization; (f) Component IG; or (g) Other. When audit findings are the source of weakness identification, identify the title, number and date of the document in which the weakness was identified. If the weakness was identified by more than one source, list all identifying sources in order of significance.

10. **Major Milestones to Include Progress to Date:** Use a milestone chart indicating actions taken and actions planned for the future. Separate milestones into three categories: (a) Completed Milestones, (b) Planned Milestones for Fiscal Year 2007, and (c) Planned Milestones Beyond Fiscal Year 2007. List only major milestones in chronological order by milestone completion date with the terminal milestone listed last. Provide the quarter and fiscal year that each major milestone is projected to be accomplished. Any corrective actions reported in the FY 2005 Performance and Accountability Report as a sample corrective action, must be reported each year until resolved indicating the revised targeted completion date (quarter and fiscal year) or that it is completed. The terminal milestone is the final corrective action, and **should either be or include the validation that the weakness is corrected**.

TAB B-2 EXAMPLE

(TAB B-2)

UNCORRECTED MATERIAL WEAKNESS STATUS OF CORRECTIVE ACTIONS

“Uncorrected Weaknesses Identified During Prior Periods”

Title and Description of Issue: Contract Administration of Service Contracts. There is a significant weakness in administering service contracts which includes ineffective planning for quality assurance requirements and inadequate training. A lack of surveillance plans has resulted in no systematic inspection system or effective documentation of contract performance. Procedures for validating and approving contractor invoices sometimes were inadequate and responsibilities and processes for approving invoices were not properly defined.

Functional Category: Contract Administration

Component: Army

Senior Official In Charge: Mr. Robert Taylor, Principal Deputy, Assistant Secretary of the Army (Acquisition, Logistics and Technology)

Pace of Corrective Action:

Year Identified: FY 2003

Original Targeted Correction Date: 2nd Qtr, FY 2005

Target Correction Date in Last Year's Report: 4th Qtr, FY 2007

Current Target Date: 4th Qtr, FY 2007

Reason for Change in Date: N/A

Validation Indicator: The United States Army Audit Agency (USAAA) will review the effectiveness of these corrective actions in resolving the material weakness and track milestone completion.

Results Indicator: The Army has addressed every USAAA finding and initiated corrective action.

Source(s) Identifying Weakness: USAAA audit report dated September 23, 2002, "Managing Service Contracts," Audit Report A-2002-0580-AMA.

Major Milestones to Include Progress to Date:

A. Completed Milestones:

<u>Date:</u>	<u>Milestone:</u>
Completed	Instructed contracting officers to orient evaluators on the specific types of contracts and specific contract links. Clarified existing guidance on quality assurance surveillance plans. Recommended to Major Command (MACOMs) that they review guidance on surveillance when performing contract management reviews. Issued guidance to require contracting officers to periodically review the Contracting Officer Representative (COR) contract files and provide the review results to the activity director.

B. Planned Milestones for Fiscal Year 2007:

<u>Date:</u>	<u>Milestone:</u>
2 nd Qtr, FY 2007	Issue guidance to the acquisition community instructing contracting officers to establish the appropriate responsibilities and limitations for appointment letters.
3 rd Qtr, FY 2007	USAAA review and validate that the weakness is corrected.

C. Planned Milestones Beyond Fiscal Year 2007: N/A

MATERIAL WEAKNESSES CORRECTED THIS PERIOD

(TAB B-3)

(Also for TABs D-3, E-3, F-3 and so on, for FMFIA Over Financial Reporting)

Use TAB B-3 to provide a narrative for each material weakness for which corrective actions were completed in FY 2006. Begin each material weakness narrative at the top of a new page. Group information into two subsections: "Identified During the Period" and "Identified During Prior Periods."

For weaknesses appearing in TAB B-3 use the format and data requirements identified for TAB B-2, Item 10, "Major Milestones to Include Progress to Date," however, it should only reflect completed milestones.

TAB B-3 EXAMPLE

(TAB B-3) MATERIAL WEAKNESSES CORRECTED THIS PERIOD “Identified During Prior Periods”

Title and Description of Issue: Independent Logistics Assessment (ILA) Process. The Navy did not effectively implement the ILA Process. Specifically, Program Executive Offices (PEOs) and Systems Commands (SYSCOMs) did not perform a significant number of ILAs, and did not always disclose results or the basis of logistics certifications to Milestone Decision Authorities. Ambiguous language and vague references in the policy documents did not support effective implementation and implied that performing ILAs was optimal. This adversely impacted the Assistant Secretary of the Navy's (Research, Development and Acquisition) strategic goals of improving business processes and improving warfighter satisfaction.

Functional Category: Supply Operations

Component: Navy

Senior Official in Charge: Mr. John Paul Jones, Deputy Director of Supply and Acquisitions, Navy

Pace of Corrective Action:

Year Identified: FY 2004

Original Targeted Correction Date: 2nd Qtr, FY 2005

Targeted Correction Date in Last Year's Report: 4th Qtr, FY 2006

Current Target Date: N/A

Reason for Change in Date: N/A

Validation Indicator: All corrective action(s) were certified by an internal review audit.

Results Indicator: Overall, the number of ILAs performed would be accurate, and the results or the basis of the logistics certification would be disclosed to the appropriate parties for making informed decisions.

Source(s) Identifying the Weakness: Naval Audit Service (NAVAUDSVC, NAVAUDSVC Report No. N2000-0027, “Independent Logistics Assessment Process,” June 27, 2000.

Major Milestones to Include Progress to Date:

A. Completed Milestones:

Date:

Milestone:

Completed

Revised Navy acquisition policy to clearly state: (a) whether or not performing independent assessments of logistics is a requirement, and is the basis for logistics certification;

Major Milestones to Include Progress to Date (continued):

A. Completed Milestones (continued):

<u>Date:</u>	<u>Milestone:</u>
Completed	(b) the desired outcome of the ILA process, and (c) whether or not use of a Chief of Naval Operations (CNO) – validated assessment process is required.
Completed	Revised ILA policy to: (a) clearly articulate the desired outcome of the ILA process; (b) clarify the full scope of individual implementation procedures which include the overall management of ILAs and all associated responsibilities; (c) clearly define procedures for submitting the ILA implementation procedures for validation; and (d) provide guidelines for development and implementation that ensure timely and effective supportability review and an opportunity for the decision process prior to initial operational capability.
Completed	Revised SECNAVINST 4105.1, which addresses ILAs in detail, to provide additional guidance to SYSCOMS, PEOs, and Program Managers.
Completed	Validation occurred through an on-site internal review audit.

DoD Internal Control Reporting Functional Categories

Group material weaknesses, both uncorrected and corrected, by the DoD functional category designations listed and defined below.

1. Research, Development, Test, and Evaluation. The basic project definition, approval, and transition from basic research through development, test, and evaluation and all DoD and contractor operations involved in accomplishing the project work, excluding the support functions covered in separate reporting categories such as Procurement and Contract Administration.

2. Major Systems Acquisition. Items designated as major systems and are subject to the procedures of the Defense Acquisition Board, the Military Services Acquisition Review Councils, or the Selected Acquisition Reporting System. DoDD 5000.1, “The Defense Acquisition System,” May 12, 2003, may be helpful when evaluating a weakness for inclusion in this category.

3. Procurement. The decisions to purchase items and services with certain actions to award and amend contracts (e.g., contractual provisions, type of contract, invitation to bid, independent Government cost estimate, technical specifications, evaluation and selection process, pricing, and reporting).

4. Contract Administration. The fulfillment of contractual requirements including performance and delivery, quality control and testing to meet specifications, performance acceptance, billing and payment controls, justification for contractual amendments, and actions to protect the best interests of the Government.

5. Force Readiness. The operational readiness capability of combat and combat support (both Active and Reserve) forces based on analyses of the use of resources to attain required combat capability or readiness levels.

6. Manufacturing, Maintenance, and Repair. The management and operation of in-house and contractor-operated facilities performing maintenance and repair and/or installation of modifications to materiel, equipment, and supplies. Includes depot and arsenal-type facilities as well as intermediate and unit levels of military organizations.

7. Supply Operations. The supply operations at the wholesale (depot and inventory control point) level from the initial determination of materiel requirements through receipt, storage, issue reporting, and inventory control (excluding the procurement of materiel and supplies). Covers all supply operations at retail (customer) level, including the accountability and control for supplies and equipment of all commodities in the supply accounts of all units and organizations (excluding the procurement of materiel, equipment, and supplies).

8. Property Management. Construction, rehabilitation, modernization, expansion, improvement, management, and control over real and installed property, and facilities (both military and civil works construction) and includes all phases of property life-cycle management. Also covers disposal actions for all materiel, equipment, and supplies including the Defense Reutilization and Marketing System.

9. Communications and/or Intelligence and/or Security. The plans, operations, systems, and management activities for accomplishing the communications and intelligence missions and safeguarding classified resources (not peripheral assets and support functions covered by other reporting categories). Also covers the DoD programs for protection of classified information.

10. Information Technology. The design, development, testing, approval, deployment, use, and security of automated information systems (using a combination of computer hardware, software, data or telecommunications that performs functions such as collecting, processing, storing, transmitting or displaying information) and other technologies for processing management information. This includes requirements for justification of equipment and software. The DoDD 8000.1, "Management of DoD Information Resources and Information Technology," February 27, 2002, may be helpful when evaluating a weakness for inclusion in this category.

11. Personnel and/or Organization Management. Authorizations, recruitment, training, assignment, use, development, and management of military and civilian personnel of the Department of Defense. Also includes the operations of headquarters organizations. Contract personnel are not covered by this category.

12. Comptroller and/or Resource Management. The budget process, finance and accounting, cost analysis, productivity and management improvement, and the general allocation and continuing evaluation of available resources to accomplish mission objectives. Includes pay and allowances for all DoD personnel and all financial management areas not covered by other reporting categories, including those in connection with OMB Circular A-76, Performance of Commercial Activities, May 29, 2003.

13. Support Services. All support service functions financed from appropriated funds not covered by the other reporting categories such as healthcare, veterinary care, and legal and public affairs services. All nonappropriated fund activities are also covered by this category.

14. Security Assistance. Management of DoD Foreign Military Sales, Grant Aid, and International Military Education and Training Programs.

15. Other (Primarily Transportation). All functional responsibilities not contained in sections 1. through 14., including management and use of land, sea, and air transportation for movement of personnel, materiel, supplies, and equipment using both military and civilian sources.

16. Financial Reporting. Processes, procedures, and systems used to prepare, compile, and generate the Department of Defense's financial statements according to Section 3512 of title 31, United States Code; DoDD 8910.1-M, "DoD Procedures for Management of Information Requirements," June 1998; the Federal Accounting Standards Advisory Board (FASAB); the Department of the Treasury Manual Treasury Financial Manual, Volume 1: Federal Agencies; the United States Standard General Ledger (USSGL); OMB Circular No. A-136, "Financial Reporting Requirements," December 21, 2004; OMB Bulletin No. 01-09, "Form and Content of Agency Financial Statements," September, 25, 2001; and DoDI 7000.14-R, "DoD Financial Management Regulation."

PART II

GUIDELINES

FOR PREPARATION OF THE

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)

ANNUAL STATEMENT OF ASSURANCE

OVER FINANCIAL

REPORTING PROCESS

FISCAL YEAR 2006

PART II

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GUIDELINES FOR FMFIA OVER FINANCIAL REPORTING PROCESS STATEMENT OF ASSURANCE

The Heads of the Department of Defense (DoD) Components shown in Table 1 on pages 11 and 12, are required to provide the **Secretary of Defense** a FMFIA Over Financial Reporting Statement of Assurance on the effectiveness of internal control over financial reporting. This statement must be based on an assessment strictly following the requirements of OMB Circular A-123, Appendix A, the Chief Financial Officer's (CFOC) Implementation Guide and this annual guidance. The assessments of internal controls within the FMFIA Over Financial Reporting Process will disclose material weaknesses identified in the reliability of financial reporting of the quarterly and annual financial statements. This statement will describe the plans and schedules to correct any material weaknesses reported using the same format for the material weaknesses status reports as provided on pages 16 through 26 of Part I of this annual guidance. **The Head (or principal deputy) of the Component must sign the statement.** This signature authority may not be delegated below the level of DoD Component principal deputy.

The statement will cover the fiscal year and be effective *as of June 30th, of the fiscal year (FY) 2006*. Any previously reported material weaknesses should not be reported as closed until all corrective actions have been implemented and a validation of closure accomplished. If a material weakness is expected to be corrected within the 4th Quarter (Qtr) of FY 2006 but all actions are not completed as of June 30th, the DoD Component Head should report the material weakness as still ongoing.

Each Statement of Assurance submission shall consist of the following:

1. A cover memorandum, as described on pages 5 through 7, shall be **addressed to the Secretary of Defense and signed by the Head of the DoD Component, or the principal deputy**. As the example cover memorandum on page 7 shows, the FMFIA Over Financial Reporting Statement of Assurance will be presented in separate paragraph(s) on the same cover memorandum as the FMFIA Overall Process Statement of Assurance. Therefore, the Head of the Component will only be required to sign one memorandum regardless of the number of Financial Statement Reporting Entities (FSREs) for which the Component must provide financial reporting assurance. A separate paragraph for each statement of assurance over financial reporting will provide the assessment by the Component's senior management as to whether there is reasonable assurance that the Component's internal controls are in place, operating effectively, and being used for the financial reporting of each FSRE according to the OMB Circular A-123, "Management's Responsibility for Internal Control," August 5, 2005, Appendix A in one of three forms as discussed below. In some cases, the FMFIA Over Financial Reporting assurance may not have the same level of assurance as the FMFIA Overall, e.g., the Component could have an unqualified assurance on the overall and a qualified assurance on the financial reporting for the FSRE. In another example, the Component could have a qualified assurance on the overall and an unqualified assurance for the financial reporting for FSRE #1, but then no assurance on the financial reporting for FSRE #2. Regardless of the number of FSREs, a separate paragraph should cover the assurance level for the financial reporting of each FSRE.

- a. **An unqualified Statement of Assurance** (reasonable assurance with no material weaknesses reported). Each unqualified statement shall provide a firm basis for that position, which the Head (or principal deputy) will summarize in the cover memorandum.

b. A qualified Statement of Assurance (reasonable assurance with exception of one or more material weakness(es) noted). The cover memorandum must cite the material weakness(es) in internal controls that precludes an unqualified statement.

c. A Statement of No Assurance (no reasonable assurance because no assessments conducted or the noted material weaknesses are pervasive). The Head (or principal deputy) shall provide an extensive rationale for this position.

2. TABs D-1, E-1, F-1, and so on: For each FSRE, provide a list of the titles of all uncorrected and corrected material weaknesses. Use the same format as described on pages 17 and 18 in Part 1. The numbering of the tabs will begin with TAB D because TAB B is for the material weaknesses of the FMFIA Overall and TAB C is reserved for systemic weakness write-ups by the OSD Component discussed on page 6 in Part I of the annual guidance. If the Component has three FSREs and each has material weaknesses that are being reported, TAB D-1 can provide the material weakness information for FSRE #1, TAB E-1 is for FSRE #2, and TAB F-1 is for FSRE #3. Each tab must reflect the name of the FSRE for which it applies.

3. TABs D-2, E-2, F-2, and so on (Uncorrected Weaknesses): For each FSRE, provide detailed narrative descriptions of all uncorrected material weaknesses including the plans and schedules for the corrective actions. Use the instructions on pages 19 through 22 in Part I of this annual guidance.

4. TABs D-3, E-3, F-3, and so on (Corrected Weaknesses): For each FSRE, provide a brief narrative describing the material weaknesses corrected in the current year, including the most significant actions taken to correct the weakness. Use the instructions on pages 22 through 24 in Part I of this annual guidance.

An example of the FMFIA Over Financial Reporting Statement of Assurance for the fictitious Defense Aircraft Agency General Fund is shown on page 7, TAB D-1 on page 8, TAB D-2 on page 9, and D-3 on page 10.

**FMFIA OVERALL STATEMENT OF ASSURANCE WHEN ONE OR MORE
STATEMENT(S) OF ASSURANCE OVER FINANCIAL REPORTING IS REQUIRED**

Sample Cover Memorandum

MEMORANDUM FOR THE SECRETARY OF DEFENSE (Components must address the cover memorandum to the Secretary of Defense. If addressed to other than the Secretary of Defense, the memorandum will be returned for revision. Revisions risk delays that could adversely affect the accuracy and timeliness of the Secretary of Defense Statement of Assurance to the OMB, Congress, and the President.)

SUBJECT: Annual Statement Required under the Federal Managers' Financial Integrity Act (FMFIA) of 1982

As **(title of Component Head or Principal Deputy)** of **(name of Component)**, I recognize that the **(name of Component's)** management is responsible for establishing and maintaining effective internal controls to meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). I am able to provide **[the statement must take one of three forms: "an unqualified statement of reasonable assurance" (no material weaknesses being reported); "a qualified statement of reasonable assurance" (one or more material weaknesses being reported); or "no assurance" (no processes in place to assess the internal controls or pervasive material weaknesses that cannot be assessed)]** that the **(name of Component)** internal controls meet the objectives of FMFIA overall programs, administrative and operational, **(if qualified)** with the exception of **(number)** material weakness(es) described in TAB B. These material weaknesses were found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of the date of this memorandum. Other than the material weaknesses noted in TAB B, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.

Component's statement will include the following paragraph if the Component identified material weaknesses, either in the current fiscal year or past fiscal years:

The **[Component]** FMFIA overall evaluation did identify material weaknesses. TAB B-1 is a list of material weaknesses that still require corrective action and those corrected during the period. TAB B-2 is an individual narrative for each uncorrected material weakness listed in TAB B-1. **(Include the previous two sentences if your Component has uncorrected material weaknesses.)** TAB B-3 is an individual narrative for each material weakness corrected during the period. **(Include the previous sentence if your Component corrected any material weaknesses during the past fiscal year.)**

[(The statement must include the following if the form of the statement is unqualified or qualified.) TAB A provides additional information on how the **(name of Component)** conducted the assessment of internal controls for the FMFIA overall process, which was conducted according to OMB Circular A-123, Management's Responsibility for Internal Control. In addition, TAB A provides a summary of the significant accomplishments and actions taken to improve Component internal controls during the past year.]

The Component will include a separate paragraph stating the level of assurance for each Financial Statement Reporting Entity under the Component Head's purview.

In addition, the [name of Component] conducted an internal control assessment of the effectiveness of the [Financial Statement Reporting Entity name's] internal control over financial reporting over the following focus area(s): [Components will list the focus areas assessed based on the focus areas listed in TABLE 2 on page 14, e.g., "military equipment," "real property," etc.]. The assessment of the focus areas was conducted in strict compliance with the OMB Circular A-123, Appendix A, under the oversight of the Senior Assessment Team, which is maintaining complete records of the assessment documentation. Based on the results of this evaluation, I am able to provide [the statement must take one of three forms: "an unqualified statement of assurance" (no material weaknesses being reported); "a qualified statement of assurance" (one or more material weaknesses being reported); or "no assurance" (no processes in place to assess the internal controls or pervasive material weaknesses that cannot be assessed)] that the (name of Component's) internal control over financial reporting focus areas as of June 30, 2006, was operating effectively [(if qualified "with the exception of (number) material weakness(es) described in TAB D) (or if more than one financial statement reporting entity (E, F, and so on)]. These material weaknesses were found in the internal controls over the reliability of financial reporting as of the date of this memorandum. Other than the material weaknesses noted in TAB D (or if more than one financial statement reporting entity (E, F, and so on)), the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls over financial reporting for the [name of the Financial Statement Reporting Entity]." Areas that are not inside the focus areas listed above were not assessed. Therefore, I can provide no assurance on areas that are not within the above listed focus areas for the [name of the Financial Statement Reporting Entity].

The Component's statement will include the following paragraph if the Component identified material weaknesses over financial reporting for one or more financial statement reporting entities, either in the current fiscal year or past fiscal years:

The [name of the Financial Statement Reporting Entity] FMFIA over financial reporting evaluation did identify material weaknesses. TAB D-1 [or "TAB E-1," "F-1," and so on, for each Financial Statement Reporting Entity requires a separate group of TABs for the material weaknesses], is a list of material weaknesses that still require corrective action and those corrected during the period. TAB D-2 [or "TAB E-2," "F-2," and so on] is an individual narrative for each uncorrected material weakness listed in TAB D-1 [or "TAB E-1," "F-1," and so on]. (Include the previous two sentences if your Component has uncorrected material weaknesses.) TAB D-3 [or "TAB E-3," "F-3," and so on], is an individual narrative for each material weakness corrected during the period. (Include the previous sentence if your Component corrected any material weaknesses during the past fiscal year.)

(Signature of Component Head or Principal Deputy)

Example
FMFIA OVERALL STATEMENT OF ASSURANCE WHEN ONE OR MORE
STATEMENT(S) OF ASSURANCE OVER FINANCIAL REPORTING IS REQUIRED

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required under the Federal Managers' Financial Integrity Act (FMFIA) of 1982

As Director of the Defense Aircraft Agency, I recognize that the Defense Aircraft Agency management is responsible for establishing and maintaining effective internal controls to meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). I am able to provide an unqualified statement of reasonable assurance that the Defense Aircraft Agency's internal controls meet the objectives of the FMFIA overall programs, administrative and operational.

TAB A provides additional information on how the Defense Aircraft Agency conducted the assessment of internal controls for the FMFIA overall process, which was conducted according to OMB Circular A-123, "Management's Responsibility for Internal Control."

In addition, the Defense Aircraft Agency conducted an internal control assessment of the effectiveness of the Defense Aircraft Agency General Fund's internal control over financial reporting for the following focus areas: Fund Balance with Treasury (FBWT), Real Property and Military Equipment. The assessment of the focus areas was conducted in strict compliance with the OMB Circular A-123, Appendix A, under the oversight of the Senior Assessment Team, which is maintaining complete records of the assessment documentation. Based on the results of this evaluation, I am able to provide a qualified statement of assurance that the Defense Aircraft Agency General Fund's internal control over financial reporting focus areas as of June 30, 2006, was operating effectively with the exception of the three material weaknesses described in TAB D. These material weaknesses were found in the internal controls over the reliability of financial reporting as of the date of this memorandum. Other than the material weaknesses noted in TAB D, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls over financial reporting for the Defense Aircraft Agency General Fund. Areas that are not inside the focus areas listed above were not assessed. Therefore, I can provide no assurance on areas that are not within the focus areas for the Defense Aircraft Agency General Fund listed above.

The Defense Aircraft Agency General Fund FMFIA over financial reporting evaluation did identify material weaknesses. TAB D-1 is a list of material weaknesses that still require corrective action and those corrected during the period for the Defense Aircraft Agency General Fund. TAB D-2 is an individual narrative for each uncorrected material weakness listed in TAB D-1. TAB D-3 is an individual narrative for each material weakness corrected during the period.

Jane Deer
Director, Defense Aircraft Agency

[Below are examples of TAB D-1 (Lists of All Uncorrected and Corrected Material Weaknesses), TAB D-2 (Uncorrected Material Weaknesses Status of Corrective Actions), and TAB D-3 (Material Weaknesses Corrected This Period) which correspond with the example memorandum above on page 7. For instructions on how to complete TAB D-1, D-2 and D-3, see pages 16 through 26 of Part I.]

Defense Aircraft Agency General Fund

(TAB D-1)

LISTS OF ALL UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES

Uncorrected Weaknesses Identified During the Period:

Title	Quarter (QTR) and Fiscal Year (FY) Targeted Correction Date	Page #
<u>Category: Financial Reporting</u>		
Gross Pay File Does Not Contain All of Detail Detail Gross Pay Information	2 nd Qtr, FY 2007	TAB D-2-1
Detail Gross Pay Does Not Reconcile with the Summary of Gross Pay File	2 nd Qtr, FY 2007	TAB D-2-3

Uncorrected Weaknesses Identified During Prior Periods:

Title	Year First Reported	<u>Correction QTR & FY Date</u>		Page #
		Per Last Annual Statement	Per This Annual Statement	
N/A	N/A	N/A	N/A	N/A

Corrected Weaknesses Identified During All Periods:

Title	Year First Reported	Page #
<u>Category: Financial Reporting</u>		
Employee Requested Forms Are Missing	FY 2006	TAB D-3-1

Defense Aircraft Agency General Fund

(TAB D-2)

UNCORRECTED MATERIAL WEAKNESSES STATUS CORRECTIVE ACTIONS

“Uncorrected Weaknesses Identified During the Period”

Title and Description of Issue: Gross Pay File Does Not Contain All of Detail Gross Pay Information. The inability to reconcile the two removes the ability to utilize the numbers as a control feature.

Functional Category: Financial Reporting, Fund Balance with Treasury

Component: Defense Aircraft Agency (DAA) General Fund

Senior Official In Charge: Ms. Buck Fawn, Comptroller, Defense Aircraft Agency

Pace of Corrective Action:

Year Identified: FY 2006

Original Targeted Correction Date: 2nd Qtr, FY 2007

Targeted Correction Date in Last Year's Report: N/A

Current Target Date: 2nd Qtr, FY 2007

Reason for Change in Date: N/A

Validation Indicator: The Defense Finance and Accounting Service (DFAS) Internal Review will re-compute the annual reconciliation worksheet between Detail Gross Pay and Summary of Gross Pay.

Results Indicator: Correction of the inability to reconcile the two amounts will re-establish the Detail Gross Pay and Summary Gross Pay as control features.

Source(s) Identifying Weakness: Internal Control Analysis, June 2006

Major Milestones to Include Progress to Date:

A. Completed Milestones:

Date:

Milestone:

Completed

Conducted monthly reconciliation between Detail Gross Pay and Summary of Gross Pay at the DFAS Servicing Office in Columbus, Ohio.

B. Planned Milestones for Fiscal Year 2007:

Date:

Milestone:

2nd Qtr, FY 2007

Conduct final reconciliation review at the DFAS Servicing Office in Columbus, Ohio.

C. Planned Milestones Beyond Fiscal Year 2007: N/A

Defense Aircraft Agency General Fund

(TAB D-3)

MATERIAL WEAKNESSES CORRECTED THIS PERIOD

Title and Description of Issue: Employee Requested Forms Are Missing. Forty-five percent of new employees have missing forms and those missing forms could result in incorrect payroll and personnel data about the employee. The incompleteness of the personnel source documents on that employee could further result in incorrect payroll disbursements.

Functional Category: Financial Reporting, Fund Balance with Treasury

Component: Defense Aircraft Agency (DAA) General Fund

Senior Official in Charge: Mr. Buck Fawn, Comptroller, Defense Aircraft Agency

Pace of Corrective Action:

Year Identified: FY 2006

Original Targeted Correction Date: 4th Qtr, FY 2006

Targeted Correction Date in Last Year's Report: N/A

Current Target Date: N/A

Reason for Change in Date: N/A

Validation Indicator: All corrective action(s) are certified by the responsible components upon completion and reviewed through on-site internal control review.

Results Indicator: A benchmark of at least 95% of instances where proper source documentation supports information contained in the payroll system.

Source(s) Identifying Weakness: Control Analysis, June 2006

Major Milestones to Include Progress to Date:

A. Completed Milestones:

<u>Date:</u>	<u>Milestone:</u>
Completed	Implement process that will enable at least 95% of new employee forms to be accounted for at all times.
Completed	Conducted validation review at Defense Aircraft Agency Human Resources Office.
Completed	Validation occurred through an on-site verification according to the planned validation indicator procedures.

Components and Their Financial Statement Reporting Entities Required to Submit FMFIA Over Financial Reporting Process Statement of Assurance

(TABLE 1)

Table 1 describes the listing of the 18 Components who are to submit, as a subset of the FMFIA Overall Process Statements of Assurance to the Secretary of Defense, the FMFIA Over Financial Reporting Statements of Assurance, based on the review of internal control over financial reporting performed by their Financial Statement Reporting Entity(ies).¹

Table 1	
Component	Financial Statement Reporting Entity (FSRE) and It's Parent Subcomponent
1. Office of the Secretary of Defense (OSD) (Director of Administration and Management for OSD)	1. Military Retirement Trust Fund (MRTF) General Fund (GF)/ Under Secretary of Defense (Personnel and Readiness (P&R))
	2. Medicare Eligible Retirement Health Care Fund (MERHCF) GF/ Assistant Secretary of Defense (Health Affairs)/ Under Secretary of Defense (P&R)
	3. Defense Health Program (DHP) GF/ Assistant Secretary of Defense (Health Affairs)/ Under Secretary of Defense (P&R)
	4. Chemical Biological and Defense Program (CBDP) GF/ Deputy Under Secretary of Defense (Laboratories and Basic Sciences)/ Under Secretary of Defense (Acquisition, Technology and Logistics (AT&L))
2. Department (Dept.) of the Army	5. Army GF
	6. Army Working Capital Fund (WCF)
	7. United States Army Corps of Engineers (USACE)
3. Dept. of the Navy	8. Navy GF
	9. Navy WCF
	10. Marine Corps
4. Dept. of the Air Force	11. Air Force GF
	12. Air Force WCF
5. United States Special Operations Command (USSOCOM)	13. USSOCOM GF
6. Defense Advance Research Projects Agency (DARPA)	14. DARPA GF

¹ The Financial Statement Reporting Entities (FSREs) are the organizations required by either the Office of Management and Budget (OMB) or the Department of Defense to produce stand-alone financial statements for the DoD Components.

Table 1 Continued	
Component	Financial Statement Reporting Entity (FSRE) and It's Parent Subcomponent
7. Defense Commissary Agency (DECA)	15. DECA GF
	16. DECA WCF
8. Defense Contract Audit Agency (DCAA)	17. DCAA GF
9. Defense Finance and Accounting Service (DFAS)	18. DFAS GF
	19. DFAS WCF
10. Defense Information Systems Agency (DISA)	20. DISA GF
	21. DISA WCF
11. Defense Intelligence Agency (DIA)	22. DIA
12. Defense Logistics Agency (DLA)	23. DLA GF
	24. DLA WCF
13. Defense Security Service (DSS)	25. DSS GF
	26. DSS WCF
14. Defense Threat Reduction Agency (DTRA)	27. DTRA
15. Missile Defense Agency (MDA)	28. MDA
16. National Geo-Spatial Intelligence Agency (NGA)	29. NGA
17. National Reconnaissance Office (NRO)	30. NRO
18. National Security Agency / Central Security Service (NSA/CSS)	31. NSA/CSS

INTRODUCTION TO OMB CIRCULAR A-123, APPENDIX A

This guidance is in response to OMB 123, Appendix A and describes the incremental approach that the Department of Defense (DoD) will take in implementing the requirement. To the extent possible, this guidance follows the Implementation Guide for Appendix A issued by the Chief Financial Officer's Council in July 2005.

Appendix A requires reporting on, at a minimum, the effectiveness of key business process internal controls which significantly affect financial reports. The DoD has determined that limiting assessments to key focus areas material to DoD would be the best use of resources for the Department and also result in significant benefits for its reporting entities.

Components listed on Table 2 on the next page will be responsible for preparing for the **Secretary of Defense** an annual report on the effectiveness of internal control over financial reporting. This statement, the Statement of Assurance on Internal Control over Financial Reporting, must be based on procedures prescribed in this guidance and must follow the schedule of deliverables included in this guidance.

Table 2 also presents the required focus areas for each of the 31 financial reporting entities. The 31 entities are to prepare Internal Control (IC) assessments for only those focus areas that have an "X" in the box(es) on their lines. For example, Army GF must conduct IC assessments for the following areas: FBWT, Investments, Real Property, Military Equipment, FECA, Environmental Liabilities, Appropriations Received, Areas where assertions have already been completed, and Areas where assertions will be completed by FY 2006 year-end. The DFAS WCF is required to perform IC assessments on the following areas: Real Property, FECA, and significant Areas where clean audit opinions have been achieved. All 31 reporting entities are required to provide copies of their IC assessments on Areas where assertions have been completed and Areas where assertions will be completed by FY 2006 year-end.

TABLE 2		Fiscal Year (FY) 2006 Focus Areas									
FSRE	FBWT	Investments	Real Property	Military Equip.	FECA	Env. Liabilities	Health Care*	Approp's Received	Entities with Unqualified Opinions **	Areas where Assertions have been completed	Areas where Assertions will be completed by FY 06 year -end
Army GF	X	X	X	X	X	X		X		X	X
Army WCF	X		X		X					X	X
USACE	X	X	X					X		X	X
Air Force GF	X		X	X	X	X		X		X	X
Air Force WCF	X		X		X					X	X
Navy GF	X	X	X	X	X	X		X		X	X
Navy WCF	X		X		X					X	X
Marine Corps	X		X	X	X	X		X		X	X
CBDP	X							X		X	X
DARPA	X				X			X		X	X
DCAA	X				X			X	X		
DECA GF	X		X			X		X	X		
DECA WCF	X		X		X			X	X		X
DFAS GF	X		X					X		X	X
DFAS WCF			X		X				X		
DHP	X				X		X	X		X	X
DIA	X				X			X		X	X
DISA GF	X				X			X		X	X
DISA WCF					X					X	X
DLA GF	X		X		X	X		X		X	X
DLA WCF			X		X					X	X
DSS GF	X				X			X		X	X
DSS WCF										X	X
DTRA	X		X		X	X		X	X		
MDA	X		X					X		X	X
MERHCF	X	X					X	X		X	X
MRTF	X	X						X	X		
NGA	X				X			X		X	X
NRO	X				X			X		X	X
NSA	X				X			X		X	X
USSOCOM	X		X	X				X		X	X
* Emphasis is on Medicare Eligible Retiree Health Care processes.											
** Entities with Unqualified Opinions will provide statements of assurance on internal controls over financial reporting with required supporting documentation for all key business cycles for all financial statement line items.											

REPORTING PROCESS

The process for the Statement of Assurance on Internal Control Over Financial Reporting must follow strict rules directed by a TOP DOWN focus as described in the Appendix A of the Office of Management and Budget's (OMB) Circular A-123 and the Chief Financial Officers' Council Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control Appendix A, Internal Control over Financial Reporting.

The process for preparing the Statement of Assurance on Internal Control over Financial Reporting will be conducted in the following manner:

- Establish an Entity Senior Assessment Team
- Perform risk assessments
- Identify and test internal controls
- Develop corrective action plans
- Report results

Table 1 lists the 18 Components who are to submit the Statement of Assurance on Internal Control Over Financial Reporting based on their management review of internal control over financial reporting. The 31 entities are to submit the deliverables shown in Table 3 via their respective Entity Senior Assessment Team, to the Office of the Under Secretary of Defense (Comptroller)'s Financial Improvement and Audit Readiness (FIAR) Directorate, Attention: Mrs. Braun.

Table 3	
Schedule of Deliverables	
Due Date for Electronic Submission to FIAR Directorate / Mrs. Braun	Deliverable
	<i>Assessing and Documenting</i>
December 20, 2005	A. Process Narratives, Flow Charts, and Organizational Charts for the Assigned Focus Areas
February 1, 2006	B. Risk Analyses for Assigned Focus Areas
March 20, 2006	C. List of Internal Controls and Test Plan Methodology
June 30, 2006	D1. Internal Control Review Reports (including Control Analyses)
June 30, 2006	D2. All Corrective Action Plans Entered into DoD Financial Improvement Tool
	<i>Reporting</i>
September 1, 2006	E. Statement of Assurance on Internal Controls over Financial Reporting

Establishing a Senior Assessment Team

Each of the 31 reporting entities shall establish a Senior Assessment Team (SAT). The SAT will be composed of senior leadership-level representatives, in decision-making capacities, from focus functional areas and will be responsible for preparing the Statement of Assurance on Internal Control over Financial Reporting within the prescribed process. Senior Assessment Teams shall be designated by the head of the FSRE. The Senior Assessment Team shall oversee the implementation of Appendix A of OMB Circular A-123. A highly recommended source for designating the Entity Senior Assessment Team responsibilities is the audit committee that is overseeing financial statement reporting and audit activities, provided that audit committee membership includes representatives from operational areas of the entity. The Entity Senior Assessment Team should have sufficient knowledge to recognize that corrective action plans are viable and to ensure that those action plans are accomplished.

The SAT shall document the results of the assessments of risk and internal controls for each of the focus areas where an “X” appears on Table 2. The internal controls contained in any material financial or mixed information technology system(s) (e.g., the Defense Property Accountability System (DPAS)) that pertain to any focus area must also be assessed. This will most likely require coordination with other organizations. Each SAT must ensure that sufficient documentation is retained to explain significant decisions made in identifying material business process, results of the assessments, internal control test plans, and in determining which weaknesses to report outside of the entity. Documentation shall also include support for deliverables listed above.

The FSRE Appendix A Point Of Contact (POC) for each Senior Assessment Team shall provide to Mrs. Mary Braun (in the FIAR Directorate), at mary.braun@osd.mil two hard copies and one electronic copy of the deliverables as established in Table 3, no later than the due dates. For classified data, the POC will contact Mrs. Braun for transmitting instructions.

Identifying Key Business and Financial Reporting Processes

Assessments for the DoD focus areas must contain a risk analysis of all material business cycles that affect the particular DoD focus area. To identify the business cycles that impact the focus areas, determine what business transactions materially affect related account balances. Ask, “What significantly increases or decreases financial balances in this focus area?” If DFAS is the organization’s accounting service provider, DFAS may be able to provide assistance in identifying significant types of transactions which represent a material business cycle. The DoD has established its level of materiality for FY 2006 as 0.99 percent of adjusted assets for Balance Sheet accounts and 0.99 percent of total budgetary resources for Statement of Budgetary Resources accounts. Adjusted assets are calculated by subtracting the total intragovernmental assets (as indicated on the financial statements) from total assets.

Preparing Process Flow Charts

To begin the flowchart process, describe, in narrative form, the steps in the process which cause an operational event to become a financial transaction. Analyze the processes from the point of origin to the financial report and then from the financial report back to the point of origin in order to capture all transaction types, service providers, and systems used in the process.

From process narratives, flowchart the processes in a vertical swim-lane format using Microsoft Word flowcharting capabilities. The flowcharts of the processes must identify the most current key business processes and their related key controls. Only **key processes** and their related **key controls** are to be flowcharted. Flowcharts should be at a high level with interoffice transfers identified by the use of adjectives; i.e., **approved, supported** timekeeping records are entered into DCPS. If an entity has multiple processes to accomplish the same objective, the entity will submit one predominant process for the entity. The entity's internal flowcharts may be more detailed than those submitted to DoD for the purpose of ensuring that all internal controls are documented and operating effectively. Where material portions of key processes are performed by organizations other than the reporting entity, it will be necessary for the reporting entity to obtain from the service provider either assertions or flowcharts with corresponding internal control assessments in order to complete the entire process flowchart.

Note: Swim lane headers should be names of organizations (offices) performing functions within the lane. Header names should never be functions.

To facilitate consolidating similar functions into the DoD position, flowchart deliverables shall include the name, phone number and email address of an operational point of contact, flowcharts, process narratives, and the entity's organizational chart. Organization charts must reflect the chain of command for the department(s) described in the flowcharts.

Flowchart deliverables are due to the FIAR Directorate, Attn: Mrs. Mary Braun no later than December 20, 2005.

A sample flowchart process is shown in Section A. The narrative and related flowchart are at a detailed level for clarification and instructional purposes and represent the types of documents the reporting organization might use for testing and monitoring purposes. However, narratives and related flowcharts submitted to the Department of Defense (DoD) should be at a high level.

Preparing Risk Assessments

Once key processes have been identified, a risk analysis must be conducted on those processes and the related controls which are designed and operating to mitigate risk(s). Risk assessment documentation will be according to Appendix A of OMB Circular A-123 and the Chief Financial Officer's Council's Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control Appendix A, Internal Control over Financial Reporting, using the DoD Risk Assessment and Internal Control Assessment forms. The Appendix A forms will be accessible on the DoD Comptroller's public web site, under Financial Management Topics/Federal Managers' Financial Integrity Act/FY 2005/Appendix A. Forms will be available after the FY 2005 Annual Financial Statement of Assurance has been published on the website.

Transactions are particularly vulnerable to risk when they pass from one swim-lane to another, either manually or electronically. They are more vulnerable if they are complex, high in volume, and significantly impact financial reports. Table 4 provides a guide to assessing risk. As transactions pass from one swim-lane to another, management implicitly represents that the five assertions shown below are embodied in the financial transaction. A risk assessment determines where risk exists that

might circumvent one or more of these assertions. Management must identify what significant risks exist with regard to its assertions. An excellent way to recognize a risk is to find where the process crosses different areas of responsibility or to identify where responsibilities are being passed from one place or person to another. Then consider what control is in place to mitigate the risk.

- Existence or Occurrence: Management represents that all financial components of the transaction actually existed at a given date or occurred during the accounting period.
- Completeness: Management represents that all transactions and accounts that should be presented in the financial reports are included.
- Rights and Obligations: Management represents that recorded assets are the rights (ownership or preponderant responsibility for reporting) of the entity and that recorded liabilities are the obligations of the entity at a given date.
- Valuation or Allocation (Accuracy): Management represents that assets, liabilities, revenues, and expenses have been included in the financial reports at appropriate amounts.
- Presentation and Disclosure (Reporting): Management represents that the financial reports are properly classified, described, and disclosed.

Risk may be related to the control itself (lack thereof, poor design, ineffective), or it may be related to the nature of the process – inherently risky. Risk may be high due to the combination of the two types of risk. Risks are defined below:

- **Control Risk**: The risk that a material misstatement could occur in an assertion and will not be prevented or detected and corrected on a timely basis by the entity's internal control. The use of professional judgment is essential in assessing control risk.
 - Low Control Risk: The preparer believes that controls WILL prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality.
 - Moderate Control Risk: The preparer believes that controls will MORE LIKELY THAN NOT prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality.
 - High Control Risk: The preparer believes that controls will MORE UNLIKELY THAN LIKELY prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality.
- **Inherent Risk**: The susceptibility of a material misstatement, assuming that there are no related internal controls.
- **Combined Risk**: Consists of the risks that (1) a financial statement assertion is susceptible to material misstatement (inherent risk) and (2) such misstatement is not prevented or detected on a timely basis by the entity's internal control (control risk). The use of professional judgment is essential in assessing combined risk.
 - Low Combined Risk: Based on the evaluation of inherent risk and control risk, but prior to the application of testing procedures, the preparer believes that any aggregate misstatements in the assertion do not exceed design materiality.
 - Moderate Combined Risk: Based on the evaluation of inherent risk and control risk, but prior to the application of testing procedures, the preparer believes that it is MORE LIKELY THAN NOT that any aggregate misstatements in the assertion do not exceed design materiality.

- **High Combined Risk:** Based on the evaluation of inherent risk and control risk, but prior to the application of testing procedures, the preparer believes that it is **MORE UNLIKELY THAN LIKELY** that any aggregate misstatements in the assertion do not exceed design materiality.

Perform the risk assessment on the DoD Risk Assessment Form using the business process flowcharts of key processes to identify risk.

The Risk Assessment deliverable consists of the DoD Risk Assessment form, completed in Columns 1 through 11, for each process reported on December 20.

A sample risk assessment is shown in Section B.

Table 4

Risk Assessment					
	Event	Event	Event	Event	Event
example:	Purchasing	Receiving	Vendor Maintenance	Invoice Processing	Disbursement
High Risk					
Complex programs/operations					
Complex transactions					
Use of accounting estimates					
Extensive manual processes/applications					
Decentralized accounting/reporting functions					
Changes in operating environment					
Significant personnel changes					
New/revamped information systems					
New programs/operations					
New technology					
Moderate Risk					
Amended laws/regulations					
New accounting standards					
Personnel constraints					
Centralized accounting/reporting functions					
Static operating environment					
Low Risk					
Simple operations/accounting transactions					
Low transaction volume					
Management's Risk Assessment					

Preparing Internal Control Assessments

Each manager is responsible for establishing internal controls in his or her area of responsibility and continuously assessing the effectiveness of the internal controls to meet intended management assertions. The DoD Components are expected to conduct, at a minimum, annual independent assessments that may identify financial reporting internal control weaknesses. Continuous monitoring, supplemented by periodic assessments, should be documented in enough detail to support management's assertion as to the effectiveness of internal controls.

Once the Risk Analysis for a particular focus area has been completed, internal controls in place to mitigate risks must be identified and a control test method determined. IC test methods include interviews, observation, re-performance and, in the case of internal service providers, obtaining assurances from service providers. Submit the list of internal controls and test methods to Ms. Braun by March 20, 2006. The March 20 deliverable consists of Risk Assessment forms with Columns 12 and 13 completed.

Once internal controls have been identified, complete the Risk Analysis' corresponding Control Analysis. The Senior Assessment Team will ensure that the corresponding Control Analyses are performed for the required focus areas using the DoD Control Analysis form which automatically interacts with the DoD Risk Analysis form.

Only submit identified controls that are **key** controls. These controls will be determined to be either effective or not effective, and subsequently, either at High, Low or Moderate risk. Low or Moderate risk **key** controls shall be tested. The results of the test will determine how management will report the effectiveness of its controls.

If a Control Risk is determined to be "High," there is no need to test the control. The reasoning for not testing the controls labeled "High" is that those controls have not been implemented or are not effective in either their design or operation. Once a control risk is assessed as "High," corrective action plans are required to mitigate the risk. Only perform a Control Analysis test on those controls which have been assessed to be of either "Moderate" or "Low" Control Risk. Controls which are classified as either "Moderate" or "Low" Risk are considered to be effective by management and at the greatest risk that ineffective controls would be overlooked. Those controls which are identified as weak will have corrective action plans developed and entered into the DoD Financial Improvement and Audit Readiness web-based tool. Develop corrective action plans for High risk controls to mitigate identified weaknesses. (See Develop Corrective Actions for further guidance.)

Low or Moderate risk key controls will be tested to verify the effectiveness of the controls identified in the Risk Analysis. When developing a plan for testing controls, include tests for design effectiveness and operational effectiveness. Document all test design decisions as required by Appendix A. Guidance for determining sample sizes will be issued at a later date.

Use the DoD Control Analysis Sheet for identifying, assessing and reporting results of testing. Specific Risk Assessment cells will be automatically carried forward to the Control Analysis Sheet to avoid redundant input efforts. An example of an internal control assessment report is shown in Section C.

Preparing Corrective Action Plans

The assessments of internal controls within the financial reporting process will disclose weaknesses in internal control. This assessment process will include developing plans and schedules to correct identified material weaknesses. Corrective Action Plans will be entered into the DoD Financial Improvement and Audit Readiness web-based financial improvement tool.

Attributes for identifying a corrective action line as being relative to the Statement of Assurance on Internal Controls over Financial Reporting include:

1. when the corrective action implementation will be the responsibility of the FSRE, or
2. when the corrective action line is the responsibility of the FSRE but will be performed by another entity specified in the line text. When this condition exists, a corresponding line must appear in the corrective action plan of the other entity. The Internal Control Report containing the Corrective Action Plans is required to be received by June 30, 2006. If corresponding lines do not appear as required, the reports of both Components will be returned for reconciliation.

These attributes will be developed and incorporated in the web-based tool by February, 2006. Each corrective action entered in the web-based tool will have an attribute describing who has responsibility for performing the corrective action.

For all areas that have been identified as having a “High” Risk on the Control Analysis, management should assess whether the control risk meets the criteria for a Material Weakness, Reportable Condition, or a Control Deficiency. See Glossary for explanation of Material Weakness, Reportable Condition, and Control Deficiency.

Managers should identify deficiencies in internal controls. A **control deficiency** or combination of control deficiencies that in management’s judgment, represents significant deficiencies in the design or operation of internal control that could adversely affect the organization’s ability to meet its mission objectives is a **reportable condition** and will be internally tracked. A reportable condition that the DoD Component Head determines to be significant enough to be reported outside the Component will be considered a **material weakness** and included in the Statement of Assurance on Internal Control over Financial Reporting. The designation of a material weakness is a management judgment that should be based on relative risk and control test results. The bottom line is that the weakness is considered material if the Head (or principal deputy) of the Component determines to include the weakness in the Statement of Assurance on Internal Control over Financial Reporting submitted to the Secretary of Defense.

A **systemic weakness** is a material weakness that is reported by more than one Component. Once reported, the same material or systemic weakness should never reappear as a new, re-titled weakness in future Statements of Assurance on Internal Control over Financial Reporting. Instead, the original weakness should reflect that it was completed. The new instance should retain the same name as the original weakness but show a new date identified. For example, consider a material or systemic weakness that a Component originally identifies in FY 2006 and corrected in FY 2007. Then in FY 2008, management assessments identify related problems and the component wants to report it as a new material weakness in FY 2008. The material weakness should retain the same title as the original, but the “Year Identified” date would now appear as FY 2008, not FY 2006.

Weaknesses previously reported in the FMFIA Overall Statement of Assurance which appear to be financial in nature should not be automatically transferred to the Statement of Assurance on Internal Control over Financial Reporting. Only when a weakness has been discovered or confirmed as a result of the prescribed risk and internal control assessments and there is sufficient supporting documentation should the weakness be transferred from the Overall Statement of Assurance to the Statement of Assurance over Internal Control over Financial Reporting.

Weaknesses that slip year after year and do not meet the targeted correction dates reflect negatively on the Department's commitment to improve. Therefore, the Component's Senior Assessment Team should resolve material weaknesses as quickly as possible and ensure that the targeted correction dates are met.

Components must be careful in defining and setting the scope of the material weakness problem. For example, if the deficiency is due to inadequate controls for effectively implementing the entry of personnel data into Defense Civilian Personnel Data System (DCPDS) requirements, the reported weakness and milestones should address that problem. It is incorrect to define the problem in a broad category such as the civilian hiring practices, and then include corrective actions that narrowly address the deficiency in the entry of personnel data into DCPDS requirements. In this case, the definition and specification of the weakness scope is too broad (i.e., implying an action greater than the Component intends or is able to correct).

Sometimes it is preferable to address several related problems in one weakness statement. However, Components should be cautious when defining a weakness. For example, in addition to the hypothetical weakness stated above, a Component might have concluded that there are other control problems related to payroll processes. Combining several problems and reporting one weakness under a broad statement that the Component will correct deficiencies in the Fund Balance with Treasury process may overstate the dimensions of the weakness. Confine the weakness statement to the scope of the specific problem(s) addressed. Consolidation of like weaknesses into a single comprehensive weakness is encouraged only when appropriate conditions apply and when defined, specific actions will correct the deficiency. Avoid bundling a number of related weaknesses for the principal purpose of reducing the number of material weaknesses reported. Weaknesses defined too broadly are very difficult to resolve and usually result in repeatedly missed targeted correction dates.

PREPARING THE FMFIA OVER FINANCIAL REPORTING STATEMENT OF ASSURANCE

The statement will cover the fiscal year and be effective *as of June 30th, of the fiscal year (FY) 2006*. If a material weakness is expected to be corrected within the 4th Quarter (Qtr) of FY 2006 but all actions are not completed as of June 30th, the DoD Component Head should report the material weakness as still ongoing. Should an entity elect to contract for an audit opinion of its internal control over financial reporting, the effective date may be adjusted to coincide with the audit opinion.

Statements of Assurance will follow guidance described in pages 3 through 12. Plans and schedules to correct material weaknesses shall be reported using the same format for the material weaknesses status reports as provided in the entities' Annual FMFIA Statement of Assurance. Reported material weaknesses must be supported by documentation resulting from internal control assessments of "High Risk" or from internal control testing.

Section A

An example of a narrative and its process flowchart of the Payroll Cycle for the fictitious Defense Aircraft Agency's FBWT is given beginning with the narrative below.

Narrative, Flowcharting, and Organizational Chart Example:

Defense Aircraft Agency Payroll Narrative

New employee completes employee Human Resources (HR) form(s) and returns the forms to HR. HR inputs the employee personnel data into Defense Civilian Personnel Data System (DCPDS), and establishes a pay record in Defense Civilian Payroll System (DCPS). DCPDS interfaces nightly and tri-annually with DCPS to ensure that information contained in the two systems agree.

The employee's personnel data (i.e., allotments, TSP, Health and Life Insurance, etc.) is given to a Customer Service Representative (CSR) for input into DCPS directly by the employee after DCPDS has established a pay record in DCPS.

The Employee reports for work. During the pay period, the employee completes and submits a leave request and/or a request for overtime form(s). The timekeeper inputs the time exception(s) (i.e. annual leave, and/or overtime, etc.) into DCPS. The timekeeper notifies employee's Supervisor that the timesheet is ready for approval.

The employee's supervisor reviews the timesheet. If the timesheet meets the supervisor's criteria, the supervisor then approves the timesheet in DCPS. If the employee's supervisor rejects the timesheet, proper supporting documentation (i.e. approved annual leave, and/or overtime form(s), etc.) is requested from the timekeeper and given to the employee's supervisor. If the documentation meets the Supervisor's criteria, the supervisor then approves the timesheet in DCPS.

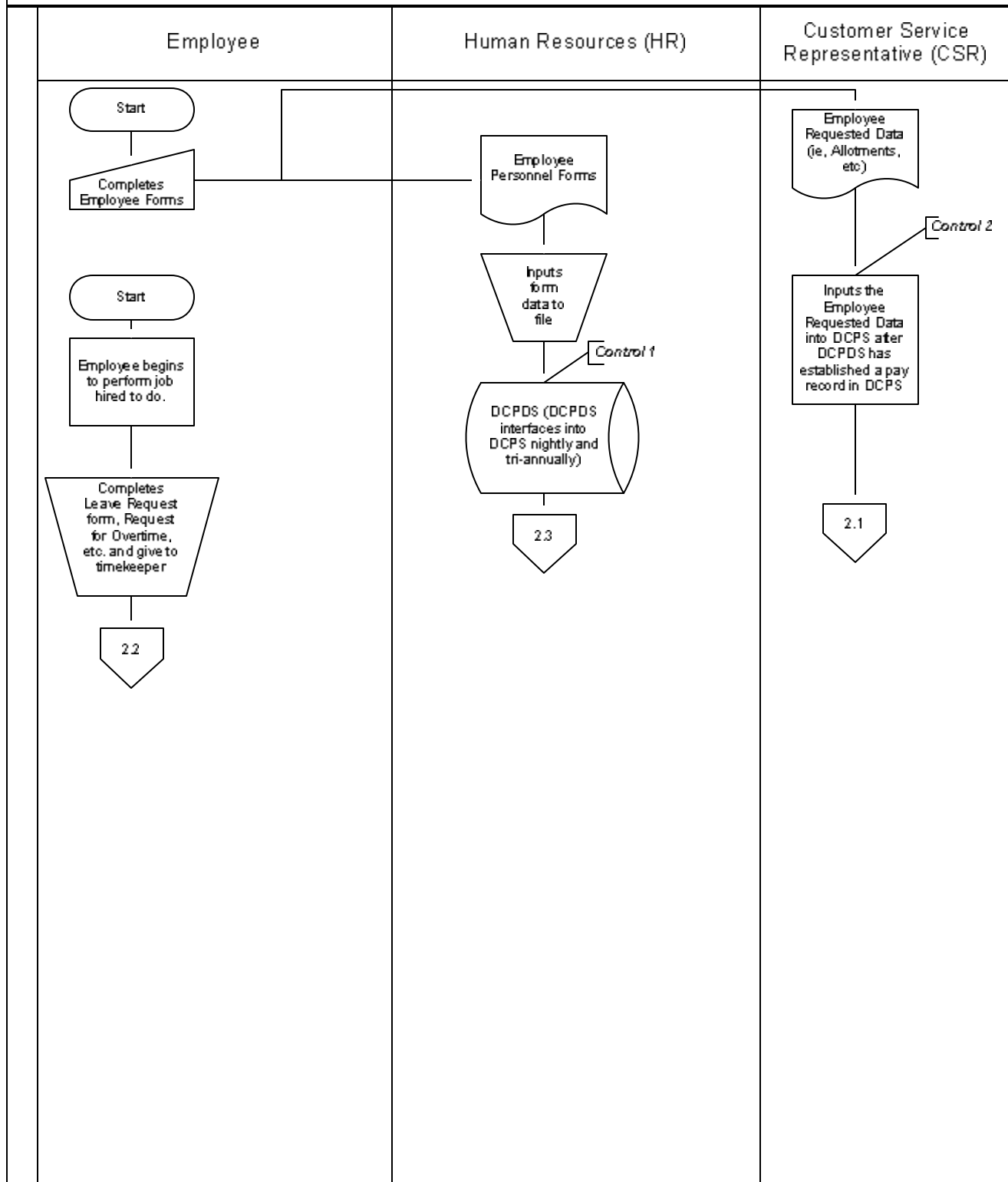
*Once the timesheet has been approved, reconciliation between DCPS and the approved timesheet occur. One of the key items of this reconciliation is to prove that the person submitting a timesheet is a valid employee of the organization and that the approving signature on the timesheet is the authorized supervisory signature to approve the particular employee's timesheet. If the reconciliation demonstrates that the information between the timesheet and DCPDS **does agree**, then the Detail Gross Pay, the Summary of Gross Pay, and the Gross to Net Payroll reports are generated. Also a new electronic timesheet is created in DCPS and a Leave and Earnings Statement (LES) is also generated. The new electronic timesheet is stored in DCPS for the next payroll cycle and the LES is mailed to the Employee. The Detail Gross Pay is sent to the multiple Accounting Installations, the Summary of Gross Pay is sent to DFAS-Columbus Departmental Accounting, and the Gross to Net Payroll is sent to DFAS-Cleveland Disbursing.*

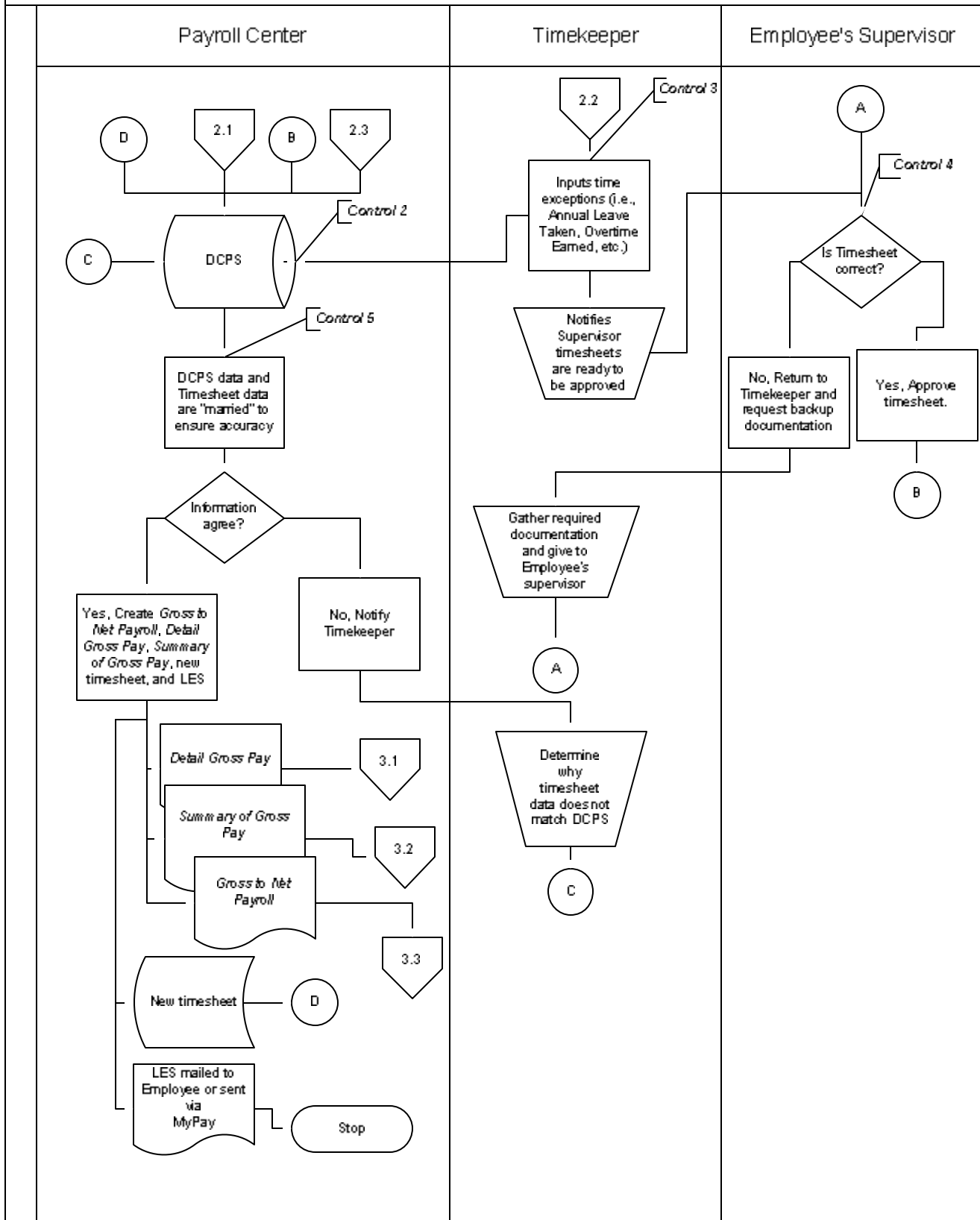
Two reconciliations then occur. First, the multiple Accounting Installations reconcile their Payroll Ledger data to the Detail Gross Pay report received from the Payroll Center. The Accounting Installations then send a Summary of the Payroll Ledger to DFAS-Columbus Departmental Accounting. Second, DFAS-Columbus Departmental Accounting reconciles the Summary of Gross Pay report received from DCPS to all of the Summary of Payroll Ledger reports received from all of their Accounting Installations in its reporting network.

*If the information between the timesheet and DCPS **does not agree**, the timekeeper is notified to determine why the information in the timesheet and DCPS does not reconcile. The timekeeper is to determine the appropriate action needed to rectify the situation.*

Disbursing receives the Gross to Net Payroll file and ensures that the file is correct by reconciling the Gross to Net Payroll transmittal letter to the file itself. Disbursing then initiates the Electronic Funds Transfer (EFT) of the payroll and sends the data to the Payroll Fund Recipients.

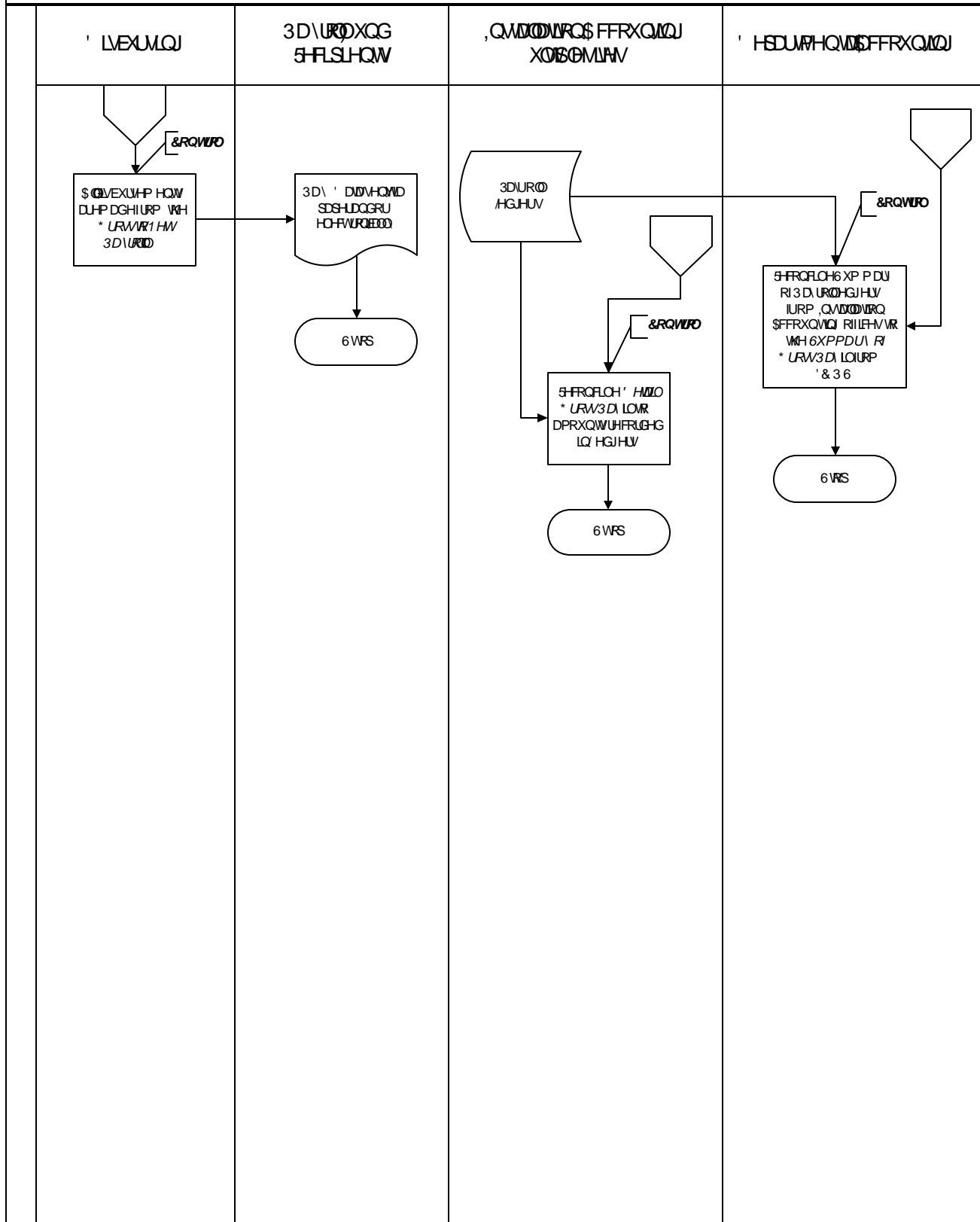
Payroll Cycle for Defense Aircraft Agency



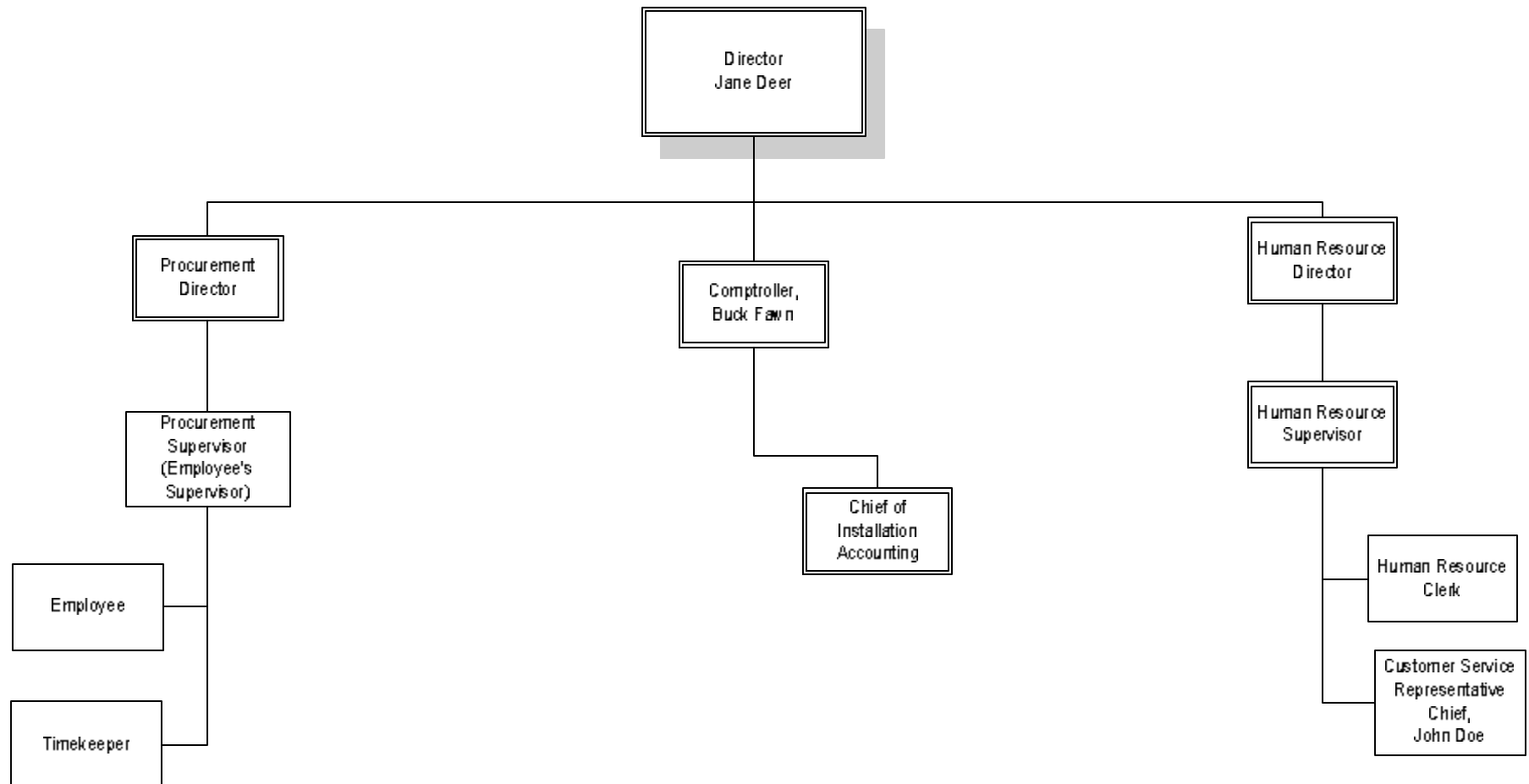


3D\URQ FQIRU HHQM\$WUD\$VHQA SDJH

) QZFKDUMQ ([DP SDH
3DJH RI



Defense Aircraft Agency Organization Chart



Section B

Risk Analysis Example

The completed Risk Analysis for the Defense Aircraft Agency is presented in Appendix B. The numbers contained in the cells of the sample Risk Analysis shown in Appendix B correlate to the instructions below (and are used ONLY for identification purposes).

1. Choose from the available drop down list your particular entity. A full list of FSREs is available on Table 2.
2. Type in the name of the Risk Analysis Preparer. This should be the person who has responsibility for performing the risk analysis of this particular Focus Area.
3. Type in the Risk Analysis Preparer's business telephone number.
4. Type in the Control Number from the Flowchart of the control that will be assessed. (See Payroll Cycle flowchart for Control Numbers.)
5. Choose from the available drop down list shown in Table 5, the Account/Line Item/Event.
For our Payroll Cycle example, the choice would be "Cash Disbursements."
6. Choose from the available drop down list, the particular Business Cycle or Accounting Application from Table 5. If "Other" is chosen, explain why in a memorandum. Each Focus Area has its own specific set of Business Cycles/Events or Accounting Applications.
In the Payroll Cycle example, "Payroll" is the Business Cycle or Accounting Application that will be assessed.
7. Choose from the available drop down list, the Assertion that is being made. See Glossary for definition and types of Assertions.
The first assertion that will be assessed in the Payroll Cycle example is "Valuation/Allocation."
8. Type in what the risk would be if a control did not exist if the preparer believes that this has a very likely chance of occurring.
For example, the first risk of not having "Control 1" of the Payroll Cycle would be that "The DCPDS will accept invalid data entered by HR personnel."
9. Select from the available drop down list the level of Inherent Risk: 1) High, 2) Moderate, or 3) Low (that is assessed by the preparer). See the Glossary for the definition of Inherent Risk.
Based on preparer's judgment for the Payroll Cycle example, if DCPDS did not have edits, the likelihood that a material misstatement on the financial statements would occur would be extremely likely. Therefore, the Inherent Risk is judged to be "High."
10. Select from the available drop down list the level of Control Risk: 1) High, 2) Moderate, or 3) Low (that is assessed by the preparer). See the Glossary for the definition of Control Risk.

Continuing the Payroll Cycle example, the risk analysis preparer realizes that DCPDS has data input edits that are to reject invalid data and believes those edits to be working properly. Hence, the Control Risk has been assessed as being "Low."

11. Select from the available drop down list the level of Combined Risk: 1) High, 2) Moderate, or 3) Low (that is assessed by the preparer). See Glossary for definition of Combined Risk.

For the Payroll Cycle example, the risk analysis preparer weighs the Inherent Risk with the Control Risk and decides whether the Control Risk mitigates the Inherent Risk to what level. The preparer decided that the Combined Risk was "Moderate" because the Inherent Risk was extremely High and the Control Risk was Low.

12. Type in the control being used by the entity to mitigate the risk described in item number 6 above.

In the Payroll Cycle example, the preparer describes the control being used to reduce the risk that invalid data is input into DCPDS. The control is "DCPDS has input edits to reject invalid data."

Information in Columns 12 and 13 are not required until March 20, 2006.

13. Type in the test method to be used to test the control. Options from the drop-down menu include interviewing, observing, re-performing or, in the case of external service providers, obtaining assurances from the service providers.

CHART 1

page 1 of 3

Risk Analysis

Entity Defense Aircraft Agency (1)*

Preparer John Doe (2) (3)

Account Line: FBWT

(4) Control Number	(5) Account/ Line Item/Event	(6) Business Cycle, Accounting Application	(7) Assertion	(8) Risk	(9) Inherent Risk	(10) Control Risk	(11) Combined Risk	(12) Internal Control Currently In Place	(13) Internal Control Test Method Used
1a	Cash Disbursements	Payroll	Valuation/Allocation	The DCPDS will accept invalid data entered by HR	High	Low	Moderate	DCPDS has edits to reject invalid data	Re-performing
1b	Cash Disbursements	Payroll	Completeness	HR omitted data (i.e. pay grade and Social Security number) into employees DCPDS profile	High	Low	Moderate	DCPDS has edits to reject incomplete employees profile	Observation
2a	Cash Disbursements	Payroll	Completeness	Employee requested forms are missing (i.e.W4, allotments etc.)	High	High	High	No control was found.	Observation
2b	Cash Disbursements	Payroll	Valuation/Allocation	Inaccurate data and wrong version offforms (i.e. W4, allotment etc.)	Low	Low	Low	CSR employee input data and another employee review for accuracy	Observation
3a	Cash Disbursements	Payroll	Completeness	Supervisor's signature omitted	Moderate	Low	Moderate	Timekeeper will not input exceptions without assigned supervisor's signature	Observation
4a	Cash Disbursements	Payroll	Completeness	Time and attendance omitted (i.e. sick, annual leave etc.)	High	Low	Low	Supervisor verifies timesheet with supporting documentation.	Observation

* Defense Aircraft Agency is a fictitious organization for this example.

CHART 1

page 2 of 3

Risk Analysis

Entity Defense Aircraft Agency (1)

Preparer Buck Fawn
(2)

(3)

Account Line: FBWT

(4) Control Number	(5) Account/ Line Item/Event	(6) Business Cycle, Accounting Application	(7) Assertion	(8) Risk	(9) Inherent Risk	(10) Control Risk	(11) Combined Risk	(12) Internal Control Currently In Place	(13) Internal Control Test Method Used
4b	Cash Disbursements	Payroll	Valuation/Allocation	Timekeeper incorrectly codes leave and hours worked into timesheet	High	Low	Low	Supervisor verify timesheet with documentation.	Observation
5a	Cash Disbursements	Payroll	Completeness	A "ghost employee" is paid	High	Low	Low	Reconciliations are performed between DCPS and DCPDS nightly.	Observation
5b	Cash Disbursements	Payroll	Valuation/Allocation	A "ghost employee" is paid	High	Low	Moderate	Reconciliations between DCPS and DCPDS are performed nightly.	Observation
6a	Cash Disbursements	Payroll	Completeness	All transactions in the Detail to Gross Pay file are not recorded in the Payroll Ledgers	High	Low	Moderate	Installation Accounting personnel reconcile the Detail Gross Pay file with the Payroll Ledgers after every payroll cycle.	Re-performance
6b	Cash Disbursements	Payroll	Valuation/Allocation	All transactions in the Detail Gross Pay file do not match the transactions recorded in the Payroll Ledgers.	High	Low	Moderate	Installation Accounting personnel reconcile the Detail Gross Pay file with the Payroll Ledgers after every payroll cycle.	Re-performance
7a	Cash Disbursements	Payroll	Valuation/Allocation	Detail Gross Pay does not reconcile with Summary of Gross Pay	High	Moderate	High	Reconciliation between Detail Gross Pay and Summary of Gross Pay are performed annually.	External Assurance

CHART 1

page 3 of 3

Risk Analysis

Entity Defense Aircraft Agency (1)

Preparer Buck Fawn
(2)

(3)

Account Line: FBWT

(4) Control Number	(5) Account/ Line Item/Event	(6) Business Cycle, Accounting Application	(7) Assertion	(8) Risk	(9) Inherent Risk	(10) Control Risk	(11) Combined Risk	(12) Internal Control Currently In Place	(13) Internal Control Test Method Used
7b	Cash Disbursements	Payroll	Completeness	Gross Pay file does not contain all of the Detail Gross Pay information	High	Moderate	High	Reconciliation between Detail Gross Pay and Summary of Gross Pay are performed annually.	External Assurance
8a	Cash Disbursements	Payroll	Completeness	Disbursing received incomplete Gross to Net Payroll reports	High	Low	Low	Disbursing received confirmation of size and amount from DCPS.	External Assurance
8b	Cash Disbursements	Payroll	Valuation/Allocation	Disbursing received inaccurate payroll report.	High	Low	Low	Disbursing received confirmation of size and amount from DCPS.	External Assurance

Table 5	
Drop Down List Selections for Column 6 of Chart 1	
Focus Area Assessed	Business Event/Cycle Accounting Application
FBWT	(+) Advances from Customers
	(+) Collections from Earnings
	(+) Receipt of Treasury Warrant
	(+) Sales
	(-) Appropriation Rescissions
	(-) Payments of Payables
	(-) Payroll
	(-) Purchase Returns
	(+/-) Cash Transfers
	(+/-) External Certification
	(+/-) Other
Investments	(+) Amortization of Discount
	(+) Interest Received
	(+) Purchase of Investment
	(-) Amortization of Premium
	(-) Sale of Investment
	(+/-) Transfer of Investment
	(+/-) Year-end Close-out
	(+/-) Other
Real Property	(+) Capital Lease
	(+) Construction in Progress (CIP) to Real Property
	(+) Contract for Construction
	(+) Leasehold Improvements
	(+) Operating Lease
	(+) Purchase of Real Property
	(+) Transfer In of Real Property
	(-) Capital Lease Amortization
	(-) Contract for Destruction
	(-) Depreciation
	(-) Destruction of Real Property
	(-) Operating Lease Amortization
	(-) Sale of Real Property
	(-) Transfer Out of Real Property
	(+/-) Other

Table 5 (Continued)	
Drop Down List Selections for Column 6 of Chart 1	
Focus Area Assessed	Business Event/Cycle Accounting Application
Military Equipment	(+) Contract for Construction
	(+) Military Equipment Found on Installation
	(+) Procurement
	(+) Purchase of Military Equipment
	(+) Transfer In of Military Equipment
	(+) Work in Progress (WIP) Military Equipment
	(+) WIP to Military Equipment
	(-) Depreciation of Military Equipment
	(-) Dispose of Military Equipment
	(-) Lost Military Equipment
	(-) Sale of Military Equipment
	(-) Transfer Out of Military Equipment
	(+/-) Year-end Close-out
	(+/-) Other
FECA	(+) Receive Bill from Department of Labor
	(-) Pay Bill from Department of Labor
	(+/-) Other
Environmental Liabilities	(+) Training Exercises
	(-) Clean-up
	(-) Pay Bill
	(+/-) EPA Decisions
	(+/-) Other
Health Care	(+) Capturing Costs of Patient Care
	(-) Funding for Health Care
	(+/-) Code Patient Care Correctly
	(+/-) 3 rd Party Insurance Billings and Revenue
	(+/-) Other
Appropriations Received	(+) Receive Appropriation
	(-) Rescind Appropriation
	(+/-) Other

Section C

Internal Control Test and Analysis Example

The numbers contained in the cells of the example Control Analysis correlate to the instructions below (and are used ONLY for identification purposes). If a column in the Control Analysis does not contain a number, data is being automatically brought over from its corresponding Risk Analysis.

1. “The **key** controls the [preparer] has identified in the risk assessment as reducing risk must be supported by tests of controls to make sure that they have been adequately designed and are operating effectively throughout all or most of the [period reviewed].”² The Control Test Objective column is to validate the assumed level of control risk (either Low or Moderate) shown in step 9 of the Risk Analysis Example. If the Control Risk was deemed to be “High” then the control is not effective at all and no reliance should be placed upon it. In such a case, the control would not be tested and there would be no objective to insert (See Control 2, in page 1 of Chart 2).

Continuing with the Payroll Cycle Example, the control test objective for the first assertion of Control 1 would be: “To validate that the Control Risk is Low.”

2. The preparer will describe the design of the control shown in the Internal Control column and how the control design was tested.

Using the Valuation/Allocation (Accuracy) assertion of Control 1 of the Payroll Cycle Example, the test would be “To input invalid data to verify if data would reject and produce an error message (re-perform).”

3. The preparer must decide if the design of the control is effective based upon the testing performed, choosing either “Yes” or “No” from the available drop down list.

4. The preparer will describe how the control operation was tested.

Continuing with Valuation/Allocation (Accuracy) assertion of Control 1 would be: “Observe HR personnel input invalid data into DCPDS (observe).”

5. The preparer must decide if the operation of the control is effective based upon the testing performed, choosing either “Yes” or “No” from the available drop down list.

6. The Control Risk Level will then be calculated if either the Control Design Test or the Control Operation Test was determined to be ineffective. The materiality of the control will determine how much to raise the risk level. For example, if the original Risk Level was “Low” and determined to be a material control, and then was tested to be ineffective for both the Design and Operation the Control Risk Level would be elevated to “High.” But if the Control Risk Level was “Low” and both the Design and Operation of the control were effective, the Control Risk Level would stay classified as “Low.”

In the Payroll Cycle of the Defense Aircraft Agency example, Control 1 is that DCPDS has edits to reject all data on the input screen if any of it is invalid data.

² Alvin A. Arens and James K. Loebbecke, *Auditing: An Integrated Approach* Seventh Edition, (Upper Saddle River, NJ: Prentice Hall, 1997), 313

When testing the design and operation of Control 1, the person administering the control test attempted to enter both valid and invalid data into the record of an employee into DCPDS. After entering the data, the system rejected the invalid data but also rejected the valid data. In this case, the design was not effective because it did not identify which data was invalid. The operation of the control was effective because it rejected all data on the input screen if one piece of data was invalid. The volume of entries that the HR personnel would have to make in a month would determine whether the control risk would be raised from “Low” to either “Moderate” or “High.” Our example assumed that the volume of entries made in a month was small; therefore, the New Control Risk Level was raised to “Moderate” instead of to “High.”

CHART 2

page 1 of 4

Control Analysis

Entity		Defense Aircraft Agency*							
Preparer		Buck Fawn							
Account Line:		FBWT							
Business Cycle, Accounting Application	Risk	Control Number	Internal Control Currently In Place	(1) Control Test Objective	(2) Description of Design Test	(3) Was Control Design Effective?	(4) Description of Control Operation Test	(5) Was Control Operation Effective?	(6) New Control Risk Level
Payroll	The DCPDS will accept invalid data entered by HR	1a	DCPDS has edits to reject invalid data	To Support that the Control Risk is Low	Input invalid data to verify if data would reject and produce error message	No	Observe HR person input invalid data into the DCPDS	Yes	Moderate
Payroll	HR omitted data (i.e. pay grade and Social Security number) into employees DCPDS profile	1b	DCPDS has edits to reject incomplete employees profile	To Support that the Control Risk is Low	If data is omitted from input screen would DCPDS produce an error message.	No	Observe HR person attempt to omit data (i.e. Social Security number) data into the DCPDS	Yes	Moderate
Payroll	Employee requested forms are missing (i.e.W4, allotments etc.)	2a	CSR has a New Employee's forms check listing	Not Applicable. This is a High Risk area					
Payroll	Inaccurate data and wrong version of forms (i.e. W4, allotment etc.)	2b	CSR employee input data and another employee review for accuracy	To Support that the Control Risk is Low	CSR employee input data and another CSR employee review the forms.	Yes	Examine forms for indication of review	Yes	Low

* Defense Aircraft Agency is a fictitious organization for this example.

CHART 2

page 2 of 4

Control Analysis

Entity		Defense Aircraft Agency							
Preparer		Buck Fawn							
Account Line:		FBWT							
Business Cycle, Accounting Application	Risk	Control Number	Internal Control Currently In Place	(1) Control Test Objective	(2) Description of Design Test	(3) Was Control Design Effective?	(4) Description of Control Operation Test	(5) Was Control Operation Effective?	(6) New Control Risk Level
Payroll	Supervisor's signature omitted	3a	Timekeeper will not input exceptions without assigned supervisor's signature	To Support that the Control Risk is Low	Examine exception forms to verify the assigned supervisor's signature	Yes	Observe to see if timekeeper will process exception w/o an assigned supervisor's signature	Yes	Low
Payroll	Time and attendance omitted (i.e. sick, annual leave etc.)	4a	Supervisor verifies timesheet with supporting documentation.	To Support that the Control Risk is Low	Examine timesheet to ensure supervisory review	Yes	Observe to see if supervisor will process timesheet w/o documentation.	Yes	Low
Payroll	Timekeeper incorrectly codes leave and hours worked into timesheet	4b	Supervisor verifies timesheet with documentation.	To Support that the Control Risk is Low	Examine timesheet to ensure supervisory review	Yes	Observe supervisor verify accuracy between exception and timesheet	Yes	Low
Payroll	A "ghost employee" is paid	5a	Reconciliations are performed between DCPS and DCPDS nightly.	To Support that the Control Risk is Low	DCPS and DCPDS send notification to HR that reconciliation was not complete.	Yes	Examine notifications that DCPS and DCPDS sent to HR	Yes	Low

CHART 2

page 3 of 4

Control Analysis

Entity		Defense Aircraft Agency							
Preparer		Buck Fawn							
Account Line:		FBWT							
Business Cycle, Accounting Application	Risk	Control Number	Internal Control Currently In Place	(1) Control Test Objective	(2) Description of Design Test	(3) Was Control Design Effective?	(4) Description of Control Operation Test	(5) Was Control Operation Effective?	(6) New Control Risk Level
Payroll	A "ghost employee" is paid	5b	Reconciliations between DCPS and DCPDS are performed nightly.	To Support that the Control Risk is Low	DCPS notifies HR that reconciliation between DCPS and timesheet data produced errors. If data is found to be inaccurate, an error exception report is produced.	Yes	Examine the notification HR received when timesheet data and DCPS did not agree.	Yes	Low
Payroll	All transactions in the Detail to Gross Pay file are not recorded in the Payroll Ledgers	6a	Installation Accounting personnel reconcile the Detail Gross Pay file with the Payroll Ledgers after every payroll cycle.	To Support that the Control Risk is Low	Review existence of reconciliation worksheet.	Yes	Re-compute reconciliation worksheet.	Yes	Low
Payroll	All transactions in the Detail Gross Pay file do not match the transactions recorded in the Payroll Ledgers.	6b	Installation Accounting personnel reconcile the Detail Gross Pay file with the Payroll Ledgers after every payroll cycle.	To Support that the Control Risk is Low	Review existence of reconciliation worksheet.	Yes	Re-compute reconciliation worksheet.	Yes	Low

CHART 2

page 4 of 4

Control Analysis

Entity **Defense Aircraft Agency**

Preparer **Buck Fawn**

Account Line: **FBWT**

Business Cycle, Accounting Application	Risk	Control Number	Internal Control Currently In Place	(1) Control Test Objective	(2) Description of Design Test	(3) Was Control Design Effective?	(4) Description of Control Operation Test	(5) Was Control Operation Effective?	(6) New Control Risk Level
Payroll	Detail Gross Pay does not reconcile with Summary of Gross Pay	7a	Reconciliation between Detail Gross Pay and Summary of Gross Pay are performed annually.	To Support that the Control Risk is Moderate	Review existence of a reconciliation worksheet between Detail Gross Pay and Summary of Gross Pay files.	Yes	Re-compute annual reconciliation worksheet between Detail Gross Pay and Summary of Gross Pay	No	High
Payroll	Gross Pay file does not contain all of the Detail Gross Pay information	7b	Reconciliation between Detail Gross Pay and Summary of Gross Pay are performed annually.	To Support that the Control Risk is Moderate	Examine check list that describe when Departmental received Detail Gross Pay information from accounting Installation	No	Review checklist to ensure that the checklist is maintained.	No	High
Payroll	Disbursing received incomplete Gross to Net Payroll reports	8a	Disbursing received confirmation of size and amount from DCPS.	To Support that the Control Risk is Low	Review existence of confirmation of size and amount from DCPS.	Yes	Examine reconciliation between Gross to Net Payroll files and its control sheet.	Yes	Low
Payroll	Disbursing received inaccurate payroll report.	8b	Disbursing received confirmation of size and amount from DCPS.	To Support that the Control Risk is Low	Examine indication of reconciliation between control sheet to Gross to Net Payroll file	Yes	Re-compute reconciliation between Gross to Net Payroll files and its control sheet.	Yes	Low

GLOSSARY

Assertion: Management representations that are embodied in financial transactions. The assertions can be either explicit or implicit and can be classified into the following broad categories³:

Existence or Occurrence: Management represents that all financial components actually existed at a given date or occurred during the accounting period.

Completeness: Management represents that all transactions and accounts that should be presented in the financial reports are included.

Rights and Obligations: Management represents that recorded assets are the rights of the entity and that recorded liabilities are the obligations of the entity at a given date.

Valuation or Allocation (Accuracy): Management represents that assets, liabilities, revenues, and expenses have been included in the financial reports at appropriate amounts.

Presentation and Disclosure (Reporting): Management represents that the financial reports' components are properly classified, described, and disclosed.

Combined Risk: Consists of the risks that (1) a financial statement assertion is susceptible to material misstatement (inherent risk), and (2) such misstatement is not prevented or detected on a timely basis by the entity's internal control (control risk). The use of professional judgment is essential in assessing combined risk.

Low Combined Risk: Based on the evaluation of inherent risk and control risk, but prior to the application of testing procedures, the preparer believes that any aggregate misstatements in the assertion do not exceed design materiality.

Moderate Combined Risk: Based on the evaluation of inherent risk and control risk, but prior to the application of testing procedures, the preparer believes that it is MORE LIKELY THAN NOT that any aggregate misstatements in the assertion do not exceed design materiality.

High Combined Risk: Based on the evaluation of inherent risk and control risk, but prior to the application of testing procedures, the preparer believes that it is MORE UNLIKELY THAN LIKELY that any aggregate misstatements in the assertion do not exceed design materiality.

³ Definitions are taken liberally from Auditing, Spring 2003 edition, by Becker Conviser CPA Review Course Development Team, page A3-3

Control Risk: The risk that a material misstatement could occur in an assertion and will not be prevented or detected and corrected on a timely basis by the entity's internal control. The use of professional judgment is essential in assessing control risk.

Low Control Risk: The preparer believes that controls WILL prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality.

Moderate Control Risk: The preparer believes that controls will MORE LIKELY THAN NOT prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality.

High Control Risk: The preparer believes that controls will MORE UNLIKELY THAN LIKELY prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality.

Inherent Risk: The susceptibility of an assertion to a material misstatement, assuming that there are no related internal controls.

Key Business Process: Process or function within an assessable unit that materially affects financial report balances.

Key Control(s): The control(s) that is/are identified to ensure that the key process(es) is/are performed completely, accurately, and correctly for the assessable unit. There can be as few as one key control, or there can be multiple key controls. Key controls are those controls that are expected to have the greatest impact on meeting the objectives of management.

PART III

**SCORECARD INFORMATION FOR THE
FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)
ANNUAL STATEMENT OF ASSURANCE**

FISCAL YEAR 2006

There are five categories scored in FY 2006.

- **Timeliness**
 - Was the statement of assurance received according to the suspense, ahead or behind the suspense date?
 - Late submission puts the Department at risk of meeting the Office of Management and Budget's deadlines.
- **Format**
 - Was the statement of assurance accurate, complete, and easy to read?
 - Was the statement compliant with guidance?
- **Program Execution**
 - Does the statement describe evidence indicating that the Managers' Internal Control Program is executed at all levels of the Component?
 - What is the extent to which the Component uses innovative methods to reach all levels of the organization?
 - Does the program executive support a timely submission with an acceptable format and prompt resolution of weaknesses?
- **Training**
 - Does the statement describe evidence of MIC Program training given at all levels of the Component?
 - What is the extent to which the Component uses innovative methods to reach all levels of the organization?
 - Is the Component sufficiently training all Component personnel?
- **Material Weakness Reporting Activity**
 - Does the statement describe progress toward correcting identified material weaknesses promptly?
 - Does the statement indicate resolution of all delinquent weaknesses? Delinquent weaknesses are UNACCEPTABLE.
 - Does the statement clearly show that the Component conducted a robust assessment of the internal controls?

The tables below describe the criteria used to score the statements.

Timeliness Category	
+3 points (Blue)	• Received on or before August 25, 2006 by close of business (COB).
+2 points (Green)	• Received after August 25, 2006 or by COB on September 4, 2006.
+1 point (Amber)	• Received after September 4, 2006 or by COB on September 6, 2006.
-1 point (Red)	• Received after September 6, 2006 or by COB on September 15, 2006.
-10 points (Black)	• Received after September 15, 2006.

Format Category	
+3 points (Blue)	<ul style="list-style-type: none"> Best in Category – Exceptional in all aspects (Accurate, complete, easy to read, and represents a good model to benchmark.)
+2 points (Green)	<ul style="list-style-type: none"> No revisions required and not necessary to ask for explanation from Component. <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> Acceptable in all aspects (Accurate, complete, fairly easy to read, and represents an acceptable model.)
+1 point (Amber)	<ul style="list-style-type: none"> Returned for correction or requested Component to clarify any aspect of the statement. <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Unsatisfactory in at least one aspect (Not accurate, not complete, not easy to read, or does not represent an acceptable model.)
-1 point (Red)	<ul style="list-style-type: none"> Extensive changes required. <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Incorrectly stated the opinion, i.e., provided an unqualified statement that should have been qualified. <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Statement is noncompliant in one or more aspects (Component failed to follow provided guidance in preparing statement.)

Program Execution Category	
+3 points (Blue)	<ul style="list-style-type: none"> Best in Category – Component reports at least one innovative measure <u>that has not been previously reported</u> to enhance Component-wide program execution. Excludes any Component that scored a RED in the Material Weakness Category.
+2 points (Green)	<ul style="list-style-type: none"> Statement clearly indicates that the Managers' Internal Control (MIC) Program is executed at all levels (Component-wide program execution).
+1 point (Amber)	<ul style="list-style-type: none"> Statement has limited evidence of Component-wide program execution.
-1 point (Red)	<ul style="list-style-type: none"> No evidence of Component-wide program execution in statement. Statement is over 15 days late (Late submission reflects poor program execution).

Training Category	
+3 points (Blue)	<ul style="list-style-type: none"> Best in Category – Component reports at least one reported innovative measure <u>that has not been previously reported</u> which enhances training of the Managers' Internal Control (MIC) Program Component-wide.
+2 points (Green)	<ul style="list-style-type: none"> Evidence in statement of Component-wide MIC Program training performed for Component managers, MIC Program coordinators, and assessable unit managers
+1 point (Amber)	<ul style="list-style-type: none"> Statement reflects training for different Component audiences but not all listed for Green score.
-1 point (Red)	<ul style="list-style-type: none"> Statement provides no evidence of Component-wide MIC Program training.

Material Weakness Reporting Activity Category	
+5 points (White)	<ul style="list-style-type: none"> 85% or more of weaknesses corrected on time in FY 2006 as targeted in FY 2005 Statement of Assurance. (There must be at least 2 weaknesses corrected.) <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> 70% or more are corrected on time and at least two weaknesses are corrected in advance of target.
+4 points (Purple)	<ul style="list-style-type: none"> 80% or more of weaknesses corrected on time. (There is no qualification on the number of weaknesses that must be corrected.) <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> 60% or more are corrected on time and more than one weakness corrected in advance of target.
+3 points (Blue)	<ul style="list-style-type: none"> 75% or more of weaknesses are corrected on time. (There is no qualification on the number that must be corrected.) <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> 50% or more are corrected on time and at least one weakness corrected in advance of target.
+2 points (Green)	<ul style="list-style-type: none"> 60% or more are corrected on time. <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> If none due for correction in FY 2006: <ul style="list-style-type: none"> At least one new weakness reported or one weakness reported as corrected in last three years. <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Statement indicates at least two deficiencies found, that do not warrant reporting as material weaknesses and statement describes actions to resolve. (Must use format described in paragraph s on page 13 of Part I.)
+1 point (Amber)	<ul style="list-style-type: none"> 50% or more corrected on time. <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> If none due for correction during FY 2006 and no new or old weaknesses in last three years, the statement of assurance must indicate at least one deficiency and actions to resolve. (Must include corrective actions using the format in paragraph s., page 13 of Part I.)
-1 point (Red)	<ul style="list-style-type: none"> No weaknesses reported as new in past three fiscal years. <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> No weaknesses corrected in past three fiscal years. <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> No deficiencies with corrective actions discussed in statement of assurance. <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Delinquent weaknesses resulting in a REDUCTION OF TOTAL SCORE as follows: (A component with remaining delinquent weaknesses would receive the next lower score in the total score of this category. For example, a Component who resolved 4 of 4 weaknesses on time would usually receive a White score of 5 points. However, if that Component also had one or more delinquent weaknesses remaining open, the total score would be reduced by one color resulting in a Purple score of 4 points.)